The Economist

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Politics this week

Oct 2nd 2008
From The Economist print edition

AP

Frantic negotiations took place after congressmen unexpectedly voted against the federal government's $700 billion **bail-out of America's banking system**. As markets around the world spun into a free fall after the vote (the Dow Jones Industrial Average plummeted by 777 points, its largest-ever such drop over a day), proponents of the bill in America and Europe urged Congress to pass the legislation in order to avoid financial catastrophe. Passage looked more likely after the Senate voted for the bill on October 1st. See article

The crisis boosted Barack Obama, who opened up a large lead over John McCain in national **polls**. He also vaulted over his rival in vital swing states, such as Florida. See article

Meanwhile, more states, including Ohio, began the process of **early voting** in the presidential election. Around a third of the electorate is expected to cast its vote before election day on November 4th.

Michael Bloomberg was poised to launch a bid for a third term as mayor of New York. To do so he will need to get a city law changed that limits mayors to two terms.

California became the first American state to require **restaurants** to display the calorie count of each item on the menu, starting in 2011.

Manto takes a hike

South Africa's new president, Kgalema Motlanthe, who is likely to serve only until the middle of next year, reappointed Trevor Manuel as finance minister. But he replaced the controversial health minister, Manto Tshabalala-Msimang, who questioned the link between HIV and AIDS, with Barbara Hogan, who strenuously opposed such views when they were also espoused by the recently ousted president, Thabo Mbeki. See article

More than two weeks after they signed an agreement to form a government of national unity in **Zimbabwe**, Robert Mugabe's ZANU-PF and Morgan Tsvangirai's Movement for Democratic Change were in deadlock over the allocation of ministries. The MDC called for Mr Mbeki, who is still the official mediator for Zimbabwe, to help resolve the issue.

Somali pirates in the Gulf of Aden captured a Ukrainian ship with 33 Soviet-era tanks on board, then demanded a ransom of $20m. More than 60 ships have been hijacked by pirates in the area this year. See article

AFP

A car-bomb attack on the edge of **Syria's** capital, Damascus, which killed 17 civilians, was followed two days later by a bomb in the northern **Lebanese** city of Tripoli, which killed five soldiers. Though details were murky, both were widely surmised to be the work of Sunni Arab jihadists opposed to the governments in both countries. See article

The **Iraqi** government took responsibility from the Americans for paying and controlling some 54,000 mainly Sunni guards stationed in Baghdad.

King Rafael

Nearly two-thirds of voters in **Ecuador** approved a new constitution, the Andean nation's 20th. It gives the president, Rafael Correa, wide-ranging new powers, including the right to stand for two more terms

and tighter control over the economy and the other branches of government. See article

Mexico's president, Felipe Calderón, sent a security package to Congress aimed at fighting a wave of drug-related violence in the country that has claimed more than 3,000 lives this year. His move followed the discovery of six more bodies in the border town of Tijuana, a day after 16 other corpses had been found.

In the midst of **Canada's** election campaign, Stephen Harper, the Conservative prime minister, was accused of plagiarism, leading to the resignation of one of his speechwriters. Large chunks of a speech Mr Harper made as opposition leader in 2003 in support of the invasion of Iraq were found to be almost identical to a similar speech given by John Howard, Australia's prime minister at the time.

A watchful eye

The European Union sent 300 observers to **Georgia** to monitor **Russia's** promised pull-out of troops. The observers were allowed into most of the buffer zones around the two enclaves of Abkhazia and South Ossetia, but the Russians are stopping them from entering the enclaves themselves.

Western election-monitors criticised both the conduct and the vote-counting in **Belarus's** parliamentary election. All the seats were won by parties backing the president, Alyaksandr Lukashenka (who has been edging towards the West in recent months). See article

Two far-right parties did well in **Austria's** general election, taking 29% of the vote between them. But neither is likely to be invited to join the government, which will probably be a revamped grand coalition of the centre-left and centre-right parties. See article

The ruling Christian Social Union did badly in **Bavaria's** state election, losing its absolute majority for the first time in 46 years. Both the CSU premier and the party chairman stepped down. See article

The crush of the crowd

At least 147 people were killed in **India** in a stampede at a Hindu temple in Jodhpur in the north-western state of Rajasthan. It was the fourth deadly stampede at a religious festival in India this year.

America's Congress approved the country's deal on civil **nuclear co-operation with India**, the last hurdle for a controversial agreement that gives India the privileges of a nuclear power without having signed the Nuclear Non-Proliferation Treaty. India and France signed a deal on co-operation in energy, paving the way for the sale of French nuclear reactors to India.

Christopher Hill, a senior American diplomat, visited **North Korea** to try to rescue a deal on denuclearisation. Meanwhile, North and **South Korea** held their first official meeting since Lee Myung-bak became the South's president in February.

Malaysia's main ruling party, the United Malays National Organisation, postponed until March its internal leadership election, the winner of which becomes prime minister. This was seen as enabling a smoother handover of power from the prime minister, Abdullah Badawi, to his deputy, Najib Razak.

Chinese astronauts successfully completed their country's first space walk. In a live broadcast on television, Zhai Zhigang, the mission leader, waved a Chinese flag 340km (210 miles) above the earth.

AFP

Economist.com BUSINESS

Business this week

Oct 2nd 2008
From The Economist print edition

More banks went to the wall amid the turmoil in financial markets caused by the uncertainty over the bail-out package. In America's biggest banking failure, **Washington Mutual** was seized by federal regulators and its banking operations sold to **JPMorgan Chase**. Separately, **Citigroup** stepped in to rescue **Wachovia**. Both deals were brokered by the Federal Deposit Insurance Corporation. See article

The crisis continues

Lifelines were also thrown to European banks. The Dutch, Belgian and Luxembourg governments partly nationalised **Fortis** amid uncertainty about its ability to sell assets it holds in ABN AMRO, a Dutch bank. **Dexia**, a Belgian-French bank, received a €6.4 billion ($9.2 billion) government cash injection. In Britain **Bradford & Bingley**, a specialist in buy-to-let mortgages, was nationalised and some assets sold to Spain's Santander. **Hypo Real Estate**, Germany's second-largest property lender, obtained €35 billion ($51 billion) in credit guarantees from the government and the banking industry. And **Glitnir**, Iceland's third-largest bank, was nationalised. See article

Ireland's government took the extraordinary step of guaranteeing all deposits in six **Irish banks** after their share prices suffered huge losses. The guarantee covers around €400 billion ($575 billion) of liabilities, more than twice Ireland's gross domestic product. Some politicians, especially in Britain, grumbled that the Irish move may be contrary to European Union competition law.

The **Reserve Bank of India** stepped in to reassure depositors that ICICI was financially sound amid reports of a wave of cash withdrawals from the bank. And **Russia** provided a further $50 billion to increase liquidity in its banking system. This comes on top of a $130 billion package doled out to Russian banks in the form of loans, tax cuts and delayed tax payments.

Apple's share price tumbled by 18% as investors fretted that consumer-technology companies would bear the brunt of a slowdown in spending. Apple's shares had only recently recovered from a similar battering in January.

GE said it was planning to offer $12 billion in common shares, and that Warren Buffett's Berkshire Hathaway would buy $3 billion in preferred shares. Jeffrey Immelt, the conglomerate's boss, was active this week in pressing politicians to pass the bail-out package because of the "negative ripple effects" of the financial crisis on business. See article

Xstrata dropped its $10 billion offer for **Lonmin**, a platinum producer, citing the risks caused by "the current lack of clarity and certainty regarding the future availability of credit". The Anglo-Swiss mining giant did, however, raise its stake in Lonmin to 25%.

A judge in Delaware ruled that **Apollo Management** must proceed with its buy-out of **Huntsman**, a chemical company. Apollo made the offer in July 2007, at the tail-end of the private-equity boom and shortly before the bust in credit markets. Apollo had argued that it was not obliged to conclude the deal because of a material adverse effect in Huntsman's business, an assessment which the judge decided was "unreliable".

Ready for take-off?

Chicago's **Midway Airport** looked set to become the first big airport in the United States to be privatised when the city's mayor accepted a $2.5 billion bid for the right to run Midway for 99 years from an investment group. Virtually all of America's commercial airports are owned by city and local governments.

A consortium led by Abertis, a Spanish infrastructure company, pulled its $12.8 billion proposal to take over the running of **Pennsylvania's turnpike**, the state's main toll road. In May the consortium, which

includes Citigroup, won the bidding for the lease with the backing of Pennsylvania's governor, but the privatisation was resisted by legislators.

After almost losing its licence to fly, **Alitalia** saw a rescue plan approved by the two remaining unions that were holding out against a deal, giving the go-ahead for a sale to **CAI**, a consortium of 16 Italian entrepreneurs led by Roberto Colaninno. Italy's government has been trying to privatise the struggling state airline for more than two years. CAI intends to relaunch a slimmer Alitalia next month, after merging its operations with Air One, a domestic rival.

Abandon ship

The **Baltic Exchange Dry index**, which measures the cost of dry bulk shipping, continued to drop. Although not as good a proxy for commodity indices as it once was, the Baltic Dry's fall is reckoned to reflect weakened demand for raw materials in China. The share prices of shipping lines in China and Japan are also sinking.

KAL's cartoon

Oct 2nd 2008
From The Economist print edition

Illustration by KAL

The credit crunch

World on the edge

Oct 2nd 2008
From The Economist print edition

Whatever happens in Congress, the crisis is now global; that means governments must work together

AMERICA'S Congress is not used to being second-guessed. But as lawmakers wrestled in the Capitol, world stockmarkets have been giving real-time odds on the Bush administration's $700 billion bail-out becoming law. After the plan's thrashing by the House of Representatives on September 29th, spurred on by voters' loathing of "casino capitalism", investors panicked. Yet as *The Economist* went to press, they were optimistic that, after winning the Senate's approval on October 1st, the plan would pass.

Even if it does, that should not be a cause for optimism. Look beyond the stockmarkets, especially at the seized-up money markets, and there is little to see except bank failures, emergency rescues and high anxiety in the credit markets. These forces are drawing the financial system closer to disaster and the rich world to the edge of a nasty recession (see article). The bail-out package should mitigate the problems, but it will not avert them.

The crisis is spreading in two directions—across the Atlantic to Europe, and out of the financial markets into the real economy. Governments have been dealing with it disaster by disaster. They have struggled to gain control not just because of the speed of contagion but also because policymakers, and the public they serve, have failed fully to grasp the breadth and depth of the crisis.

What's the Icelandic for "domino"?

Step forward, Peer Steinbrück, Germany's finance minister, who rashly declared on September 25th that America was "the source…and the focus of the crisis", before heralding the end of its role as the financial superpower. Within days, the focus shifted and Mr Steinbrück and his officials were obliged to arrange a €35 billion ($51 billion) loan from German banks and the German government to save Hypo Real Estate, the country's second-biggest property lender.

The hapless Mr Steinbrück is not alone. European banks were collapsing at a dizzying pace even as Christian Noyer, governor of the Bank of France, declared that "there is no drama in front of us." Hypo Real Estate was just one of five banks in seven European countries bailed out in three days. Belgium, Luxembourg and the Netherlands carved up Fortis, a big bancassurer; Britain nationalised Bradford & Bingley; Belgium, France and Luxembourg saved Dexia; and Iceland rescued Glitnir. Separately, Ireland took €400 billion of contingent liabilities onto the national balance sheet, when it stood behind the deposits and debts of its six large banks and building societies. You have to wonder what Mr Noyer regards as dramatic.

By some measures, many European banks look more vulnerable than their American counterparts do—and that is saying quite something, given the past week's forced sale of Washington Mutual, America's biggest thrift, and Wachovia, its fourth-biggest commercial bank. In America, outside Wall Street, the banks have lent 96 cents for each $1 of deposits. Continental European banks have lent roughly €1.40 for each €1 of deposits. They have to borrow the rest from money-market investors, who are not especially confident just now. Some Europeans, including the British, Irish and Spanish banks, have housing busts of their own. And they must contend with the toxic American securities they bought by the billion, as well as their own slowing economies.

Western Europe is not the limit of this: the panic has also struck banks in Hong Kong, Russia and now India. And it is not just the geographical breadth of this crisis that is alarming, but also its economic depth. Because it is rooted in the money markets (see article and article), it will feed through to businesses and households in every economy it hits.

Take a deep breath

Most of the time nobody notices the credit flowing through the lungs of the economy, any more than people notice the air they breathe. But everyone knows when credit stops circulating freely through markets to banks, businesses and consumers. For almost a year the markets had worried about banks' liquidity and solvency. After the bankruptcy of Lehman Brothers last month, amid confusion about whom the state would save and on what terms, they panicked. The markets for three-, six- and 12-month paper are shut, so banks must borrow even more money overnight than usual.

Banks used to borrow from each other at about 0.08 percentage points above official rates; on September 30th they paid more than four percentage points more. In one auction to get dollar funds overnight from the European Central Bank, banks were prepared to pay interest of 11%, five times the pre-crisis rate. Astonishingly, rates scaled these extremes even as the Federal Reserve promised $620 billion of extra funding.

Bankers have always earned their crust by committing money for long periods and financing that with short-term deposits and borrowing. Today, that model has warped into self-parody: many of the banks' assets are unsellable even as they have to return to the market each day to ask for lenders to vote on their survival. No wonder they are hoarding cash.

This is why those politicians who set the interests of Main Street against those of Wall Street are so wrong. Sooner or later the money markets affect every business. Companies face higher interest charges and the fear that they may one day lose access to bank loans altogether. So they, too, hoard cash, cancelling acquisitions and investments, in order to pay down debt. Managers delay new products, leave factories unbuilt, pull the plug on loss-making divisions, and cut costs and jobs. Carmakers and other manufacturers will no longer extend credit (see article) and loans will become elusive and expensive. Consumers will suffer. Unemployment will rise. Even if the credit markets work well, the rich economies will slow as the asset-price bubble pops. If credit is choked off, that slowdown could turn into a deep recession.

Financial markets need governments to set rules for them; and when markets fail, governments are often best placed to get them going again. That's pragmatism, not socialism. Helping bankers is not an end in itself. If the government could save the credit markets without bailing out the bankers, it should do so. But it cannot. Main Street needs Wall Street; and both need Washington. Politicians—and President George Bush is the most culpable among them (see article)—have failed to explain this.

Governments need not just to communicate, but also to co-ordinate. Past banking crises show that late, piecemeal rescues cost more and work less well. Ad hoc mergers work for a while, but demands for help tend to recur. Inconsistency sows uncertainty. Cross-border banking can make one country's policies awkward for the neighbours: the Irish government's guarantee of all deposits threatens to suck in money from poorly protected British banks. France's suggestion on October 1st that Europe's governments should work together was a good one; Germany's rejection of it was wrong.

Central banks have co-ordinated their liquidity operations. Now that oil prices have plunged and worries about inflation are receding, interest-rate cuts are possible. They would be more powerful if co-ordinated. But it is not only central banks that need to combine. Whatever America's Congress does, governments should work together on principles to stabilise and recapitalise banks—not just to stem panic but also to save money. Even if, as the Europeans claim, the crisis was made in America, it now belongs to

everyone.

John McCain and Barack Obama

An inconvenient truth

Oct 2nd 2008
From The Economist print edition

Thanks to the credit crisis, both presidential candidates are trading on increasingly false prospectuses

A FINANCIAL crisis on the scale of the one unfolding on Wall Street would be terrible at any juncture. But the timing of this one is astonishingly bad. In one corner is a president with just over a hundred days left to serve, who many people believe is among the most calamitous ever to occupy the White House. In the other corner is Congress, where a third of the Senate and the whole of the House face re-election in exactly one month's time. Flickering in and out of the fray are the two presidential candidates, whose campaigns have become the playthings of forces over which they have no control. If ever there were a recipe for poor political leadership, this is it.

The malign coincidence of crash and election reinforces the difficulties. Political weakness makes it hard to get to grips with a reeling economy, and the economic crisis disrupts the process of choosing a new president. Most obviously, it is distracting attention from the contest. At a time when voters ought to be weighing up the candidates' characters, records and policies, the airwaves are saturated with the grim news from the world's banks and bourses. Even worse, the crisis makes a mockery of many of the campaign promises laboriously crafted in focus groups and policy workshops, and methodically laid out on the stump and via the internet.

Read all about it

Even before the cost of bail-outs is considered, the budget deficit for the current fiscal year is estimated at slightly over $400 billion, already about 3% of GDP. If America were part of the EU, it would be facing trouble for breaching the Maastricht guidelines; and if it moves into full-blown recession next year's deficit will be a lot worse. Even though the full $700 billion cost of the proposed bail-out would be spread over several years, and the offsetting value of the loans the government intends to buy up will increase if the bail-out works, the current crisis is likely to drive a large hole through a budget that already looks stretched. Deficits do, and ought to, rise in recessions; but if they start out high and are coupled with promises of expensive tax cuts and spending boosts, the long-term consequences for the public finances are alarming.

This week we publish a special 20-page briefing looking at the pledges the two presidential candidates have made; we also have a survey of economists examining their schemes—(see article). Both men are exposed to a budget crunch (as indeed are parties elsewhere, such as Britain's Tories—see article). John McCain has the bigger tax cuts, but an empty Treasury may hurt Barack Obama more because he has proposed a lot more on the spending side. He has more promises that may have to be broken if there is no money.

To many voters, Mr Obama's most attractive single policy is that he is committed to introducing universal health coverage, ending the disgraceful situation whereby some 46m Americans have no health cover and get little or no health care until they end up in an emergency room. On top of that, tens of millions more have health cover that is restricted or inadequate, and an even larger number fear that they could fall into one or other of these categories should they lose their jobs and the health insurance that goes with them.

Fixing health care is a laudable aim, but even on Mr Obama's own reckoning, it will cost some $50 billion-65 billion a year, and most analysts think that the true price would be a lot more. Mr Obama also promises investment in alternative energy, affordable university tuition, a big push to upgrade America's crumbling infrastructure and much else. He has admitted, under questioning, that the state of the economy means that some of these promises will have to be "delayed". He has been, unsurprisingly, reluctant to say which ones.

Mr McCain's problems are rather different. He has made fewer economic promises than Mr Obama has, but the ones he has made, mainly to business in the shape of slashing corporate taxes from 35% to 25%, and allowing immediate write-offs of lots of equipment, are very expensive. One reason why our polled economists come out so heavily against Mr McCain is because the deficit would rise dramatically under his plan. Against that, few people, including probably Mr McCain himself, have ever believed that he would get his tax cuts through a Democrat-controlled Congress. To that extent at least, the Republican, who once used to be a fiscal conservative, has less to lose in the crunch. But that is hardly a flattering yardstick.

The candidates' economic plans are still a useful guide to their very different political philosophies. But when it comes to paying for it all, neither is offering much straight talk.

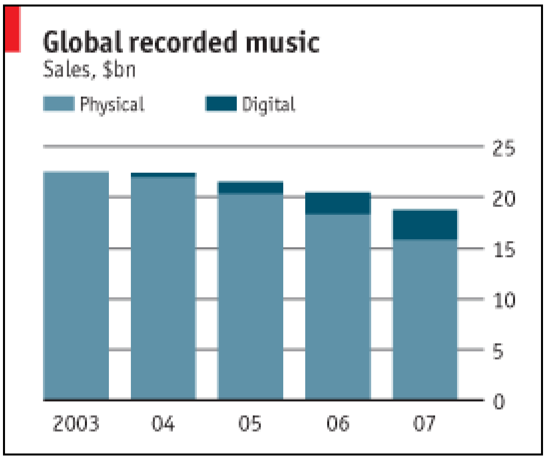
Music

A catchy new tune

Oct 2nd 2008
From The Economist print edition

After a decade of chaos, has the record industry finally hit upon the right new business model?

Get article background



SEVEN years ago, as America slipped into recession in the wake of terrorist attacks and the collapse of the dotcom bubble, Apple launched its iPod music-player. Many observers thought the company had gone mad. Apple was launching an expensive new product (the first iPod cost $399) in the depths of the worst downturn the technology industry had ever seen. It was venturing outside its familiar market, for personal computers, into the fiercely competitive field of consumer electronics. And it was taking on Sony, the giant of the industry. The iPod's name, sceptics declared, stood for "idiots price our devices".

The iPod ultimately turned out to be a smash hit, of course. Together with the iTunes download service, launched in 2003, it enabled Apple to catalyse and dominate a new digital-music industry. But even though sales of digital music are growing quickly, they are not growing fast enough to offset the rapid decline in CD sales. Internet piracy of music is not merely widespread; it is regarded as normal by a generation of young people who expect music to be free. Various other things have been tried: music as a loss leader for concert tickets, advertising-supported music services, even virtual tip jars that allow fans to pay whatever they think an album is worth. None of it has worked. If the record industry is to halt or reverse its decline, something new is needed. But what?

Whatever it is must reconcile the seemingly irreconcilable demands of consumers and the industry. For their part, consumers would like access to an easy-to-use jukebox of free, unlimited music: what Napster, the original file-swapping service, provided before being shut down. The industry, meanwhile, likes the idea of moving from selling products to selling services, and charging people a subscription for access to online music. Many such services exist: they provide record companies with predictable revenue, and consumers who are prepared to pay enough can have unlimited access. But in many cases they are locked in, and if they stop paying their subscription fees, they can no longer listen to anything.

New world music

Now, seven years after Apple's appearance on the scene, and with global markets once again in turmoil, the industry may have found a way to square these conflicting demands: hiding the cost of a music subscription inside something else. The best example for this approach is Nokia's Comes With Music (CWM) model. Buy a CWM handset and you get free, unlimited music downloads for a year. Of course, they aren't really free: the price of the handset includes a subscription fee that is passed to the record companies (see article). After a year, you can pay to continue to download new tunes, or you can buy another CWM handset, with another year of free service. Thus consumers get their music; record companies get paid; and Nokia attracts and retains customers.

This idea can be extended beyond handsets. "Free" music can also be bundled with mobile-phone contracts, broadband service, music-players, PCs or even cars. Firms that provide these things may be prepared to chip in towards the cost of the music service in return for customer loyalty. Whether all this will prove to be a sustainable new model for the industry remains unclear: a lot depends on how the different companies involved divide up the costs and benefits.

Like Apple before it, Nokia is venturing outside its market and taking on a powerful incumbent. As with

Apple seven years ago, many observers are sceptical. But the unpleasant truth is that these days many people, particularly young people, expect music to be free. The industry may finally have found a way to sustain this illusion while still getting paid.

Somalia

Piracy and much worse

Oct 2nd 2008
From The Economist print edition

What is to be done about the world's least-governed state?

Get article background

THE azure waters at the foot of the Red Sea lapping southwards round the Horn of Africa are now the most dangerous in the world. This year pirates have captured more than 60 ships. Recently a Ukrainian ship carrying 33 tanks was captured by Somali buccaneers (see article). The reason for this swirl of maritime outlawry can be found on the nearest shore, in Somalia.

Until the world's most comprehensively failed state acquires the barest modicum of order and government, the seas beside it will be a paradise for pirates and a menace to passengers, crew and cargo, even for ships sailing 300 miles offshore. Yet maritime outrages, though they help remind the world of the disaster that is Somalia, are only one reason to do something about the place. A more important one is that Somalia's people do not enjoy a scrap of security, let alone any of the material benefits of a modern state. And a final one is that the outside world helped tip Somalia into chaos.

The prescriptions for dealing with piracy are simple enough. Governments must co-operate more energetically to face down pirates and, where necessary, blast them out of the water. A coalition of countries already has a naval task-force in the area, mainly to tackle terrorism; its numbers should be bumped up and a sea lane that can be properly monitored should be defined. Ships taking food to Somalia for the UN must have a naval escort. The EU should strengthen its tiny naval cell that co-ordinates air and sea activity. The UN, along with the African Union (AU), should organise a coast guard to watch Somalia's shore. The Gulf states, in particular Saudi Arabia, should fulfil their vague promises to help pay for Somalia's recovery.

But the harder, underlying problem is Somalia itself. With no proper government since 1991, it has been a bloody kaleidoscope of competing clans and fiefs. More than 1m, in a population once around 10m, have fled abroad; this year alone, the UN reckons, some 160,000 have been uprooted from Mogadishu, the capital, which has lost about two-thirds of its inhabitants over the years. The country is too dangerous for foreign charities, diplomats or journalists to function there permanently. Thousands of angry, rootless, young Somalis are proving vulnerable to the attractions of fundamentalist Islam in the guise of al-Qaeda and similar jihadist brands. The cash from piracy is probably fuelling the violence.

In recent times Somalia has known order only briefly, in 2006, when Islamists known as the Islamic Courts Union took over. Unfortunately next-door Ethiopia, egged on by the Americans, intervened to oust them. A "transition federal government" has totally failed to impose itself. A feeble AU force has tried in vain to help. With the UN unable to drum up even half the heralded force supposed to keep the peace in Sudan's ravaged Darfur region, no one has the guts or cash to send a serious force to bring order, let alone justice, to Somalia.

And yet outsiders could still help Somalis to help themselves. A "dialogue" that started in nearby Djibouti between most of the warring factions has been going on intermittently for more than a year; the more moderate Islamists from the Courts Union must be brought in, even if the harder-line affiliates of al-Qaeda cannot be. The UN, Western governments and those in the region have a moral duty not to give up trying to bring Somalis together. Besides, wretched as it is, Somalia can cause a lot of trouble—on land and at sea. It is a disaster that the rest of the world cannot shrug off.

The European far right

Dark tales from the Vienna woods

Oct 2nd 2008
From The Economist print edition

European political leaders should do more to counter the appeal of the far right

AFP

THERE was much wailing and gnashing of teeth among liberal commentators after Austria's election on September 28th. Two far-right parties, led by Heinz-Christian Strache (pictured left) and Jörg Haider (on his right), took 29% of the vote between them. Even more disheartening, a third of the country's new young voters (the voting age has just been lowered to 16) backed them.

Austria has form. In 1999 Mr Haider's far-right party won 27% of the vote and entered a coalition government that was briefly boycotted by its European partners. This time, not least because the two far-right leaders hate each other, neither is likely to be invited into the government (see article). But although flavours of the far right vary widely, Austria is by no means alone. The Swiss People's Party of Christoph Blocher is the biggest party in Switzerland. Belgium's Vlaams Belang party remains strong in Flanders. Denmark's government depends on the backing of Pia Kjaersgaard's anti-immigrant People's Party. In Italy the Northern League, part of the ruling right-wing coalition, is explicitly xenophobic.

Some popular prejudices around Europe seem to have become distressingly illiberal and even racist. Last month a shocking opinion poll carried out by America's Pew Global Attitudes Project found that 46% of Spaniards, 36% of Poles and 25% of Germans had negative views of Jews; and 52% of Spaniards, 50% of Germans, 46% of Poles and 38% of French people had negative views of Muslims. In most countries, these numbers have risen significantly in recent years.

All of this is obviously to be deplored. The harder question is what to do about it. The Austrians argued that by including Mr Haider in government they would defang him, a trick the Swiss later tried to play on Mr Blocher. For a time it even seemed to work (though the European boycott merely annoyed Austria's voters). But the far right has since won back even more electoral ground. Elaborate steps to exclude the far right do not seem to have been any more effective. The Vlaams Belang has benefited from the other parties' decision to keep it out of government. In Austria, Germany and the Netherlands, extreme parties of both left and right tend to gain votes when the big parties form grand coalitions in the centre.

Tackling the roots

The far right has prospered most when mainstream political parties have belittled or ignored the concerns of ordinary people about such issues as immigration. It does less well when political leaders accept its existence and try to respond to its supporters' concerns. That points, for example, to reassuring voters that immigration is under control, not just to explaining why it can be beneficial. This is how the Conservative Party has neutralised the far-right vote in Britain. In the 2007 French presidential election

Nicolas Sarkozy did the same to the National Front's Jean-Marie Le Pen, who got into the run-off in 2002. Mr Sarkozy ate into Mr Le Pen's support partly by talking tough on immigration and crime.

This, however, must not include pandering to voters' racism and xenophobia. No respectable party should run on an anti-Semitic or anti-Muslim platform. Instead, political leaders should speak out loudly against all forms of prejudice. They should try to ensure that criticism of Israel does not blur into hostility to Jewry, for instance; and, equally, they should do their best to ensure that legitimate fears of Islamist terrorism do not translate into a prejudice against Muslims. Austria's politicians could make a useful start by dropping their strident opposition to the notion that Turkey, a mainly Muslim country, might ever join the European Union. Promoting the belief that the EU ought to be an exclusive Christian club is likely to promote racism, not quell it.

On water, human rights, John McCain and Barack Obama, estate taxes, Russia, the economy, Microsoft

Oct 2nd 2008
From The Economist print edition

Water rights

SIR – Your otherwise excellent article on water repeated a common misperception about the role of water pricing ("Running dry", September 20th). You attributed the "wasteful" use of water by farmers to the fact that governments "rarely charge" them a market price for the stuff. However, pricing water does little to stimulate efficiency or ensure best allocation to highest-value uses.

Consider the case of the Murray-Darling Basin. The use of water there is managed through a system of water rights, defined in terms of volumes and security of supply. During the current extensive drought, many water users are receiving only a small fraction of their "normal" entitlement. This is enforced entirely through the water-rights system—not through pricing mechanisms—enabling water to be reallocated from low-value to high-value uses; despite massive reductions in rainfall and river flows, there has been little impact on the value of agricultural production in the Basin.

There is also a long history of water rights in Spain and the western United States. Although not a panacea, tradable water rights are a central element of any integrated system designed to improve the efficiency of water use.

Don Blackmore
Former chief executive
Murray-Darling Basin Commission
Canberra

John Briscoe
World Bank country director for Brazil
Brasília

Company law

SIR – Your article on companies and human rights suggested that a panel of the International Commission of Jurists, of which I was a member, came up with a broad interpretation of corporate complicity ("Not the usual suspects", September 27th). I would like to clarify that one simply has to answer two key questions: did the company's actions have a substantial effect on the government's violations? And was the company aware of the situation?

It is misleading to suggest that the panel said that "paying taxes to a regime with an unsavoury reputation" could entail legal liability. In fact, the panel held that companies would not be legally responsible for paying generic taxes; but that there would be risks involved should they pay a "special tax" directly used by a government to finance security forces known to engage in gross human-rights abuses.

Similarly, it is hard to see how one can read the panel's complicity test as covering a company "supplying a box of pencils" to a government that uses them to write down the names of its opponents. Trivial contributions are obviously excluded by the substantial-effect test.

Andrew Clapham
Professor
Graduate Institute of International and Development Studies
Geneva

Leading and following

SIR – The responses of the presidential candidates to the tumult in our financial system have been telling ("The candidates intervene", September 27th). Barack Obama pointed consistently to the failure of trickle-down economics and blind trust in an unregulated free market, and offered four carefully balanced principles to guide immediate and longer-term solutions. John McCain changed his position daily, raging against greed, calling for the chairman of the Securities and Exchange Commission to go and for a panel to be appointed to study Wall Street's collapse.

Mr Obama called for bipartisanship, resolve instead of panic, and support for the administration as it sought to craft a strategy to turn aside catastrophe. Mr McCain's emotional appeals sank to the level of simplistic populism; his statements gave no hint that he grasps the breadth, depth, complexity, or historic proportions of this crisis. We need the balance of tempered judgment, vision, pragmatism, and stability from our leaders. Recent events tell us clearly who does and who does not offer these qualities.

Gordon Lindbloom
Portland, Oregon

A developing argument

SIR – Blake Hudson's assertion that higher estate taxes will lead to a loss of potential conservation areas, because the owners will sell the land to raise money to pay the tax, has gone unchallenged not once, but twice (Letters, September 13th and September 20th). If retaining conservation value is a primary interest for a landowner, then it is relatively straightforward to sell the development rights on the land. Such conservation easements are often worth most of the land's value and would raise the revenue to cover estate taxes. Once established, easements preserve the land from environmentally damaging development in perpetuity.

Daniel Blumstein
Associate professor of ecology and evolutionary biology
University of California, Los Angeles
Los Angeles

Russian resolve

SIR – There was a lack of historical context in your article on the present state of Russia's armed forces ("Advancing, blindly", September 20th). The Soviet Union single-handedly wiped out the vast bulk of the Nazi military machine despite poor communications, mechanical failures and many other problems that you cited as evidence of Russia's modern military impotence. Russian tenacity, stubbornness, and a willingness to win at any cost crushed the Thousand Year Reich in the 20th century, and should not be underestimated in the 21st.

Craig Brown
Buckholts, Texas

SIR – With reference to the claim that a Russian army is no match for a conventional NATO army, I would ask what NATO army? I suspect that the only impediment to Russian troops reaching the Channel would be the breakdown of their lorries and transporters.

Simon Burrage
Hay-on-Wye, Powys

Not the best timing

SIR – In the same week that Fannie Mae and Freddie Mac were rescued by the government and the process leading to Lehman Brothers' collapse began, your economic and financial indicators (September 13th) featured the World Economic Forum's inaugural Financial Development Report. This is a ranking of

52 countries “according to the strength of their financial markets, and the depth and breadth of access to capital and financial services”. Yet this survey maintains that “America and Britain have the most developed financial systems in the world”. Whatever next?

Horacio González Alemán
Madrid

Shoe circus

SIR – I am not surprised that Microsoft’s latest advertising campaign features Bill Gates needing help to buy a pair of shoes (“Postmodern wriggle”, September 13th). He is familiar with the Windows one-size-fits-all, take-it-or-leave-it brand. If a pair of Windows shoes are too tight or too loose, you are not allowed to adjust: it is forbidden by the End User License Agreement.

I would suggest Mr Gates buy a pair of Linux shoes. They come in an amazing variety of models and you can adapt them to be used as wellies, executive moccasins, trainers or even ballet shoes. And to boot, you don’t need to reach for your credit card.

Sebastià Pla Sanz
Sant Cugat del Vallès, Spain

The US-Mexican border

Good neighbours make fences

Oct 2nd 2008 | EAGLE PASS AND NOGALES
From The Economist print edition

America is building a border barrier that is both too tight and not tight enough

Corbis

FOR the past four years Steve Johnston has been dropping food, water and socks in the Sonoran desert. They are intended for illegal immigrants, who have often been walking for three or four days. Demand has never been greater. Recently Mr Johnston left 80 gallons of water beside a popular trail, and returned the next day to find all but eight gallons gone. He has encountered 40-strong groups walking in broad daylight. It is, oddly, proof that America's growing border fence is having an effect on illegal immigration.

The reason so many immigrants are tramping through Mr Johnston's neighbourhood can be found 12 miles to the south-west. Around Sasabe, steel cylinders have been sunk into the desert to create an imposing fence. That has blocked a popular migration route and driven people east. No More Deaths, a humanitarian group, has drawn up a map of migration routes based on how much water and food disappears. It looks like a leaf skeleton—a pattern of interlocking lines snaking north through the desert, then east to just above a checkpoint. From there, immigrants are driven to Tucson and Phoenix, whence they travel to wherever there are jobs.

By the end of this year the American government is supposed to have erected 670 miles of fencing along the 2,000-mile border with Mexico. Roughly half of the barrier is designed to stop everything bigger than a jackrabbit; the other half will let people through but stop vehicles. It is just part of a drive, stepped up in the past two years, to clamp down on illegal immigration and drug-smuggling. The Border Patrol is swelling from fewer than 6,000 officers in 1996 to more than 18,000 by next year. Unmanned watchtowers bristling with cameras and heat sensors are being developed. Finally, checks at proper border crossings are becoming more rigorous.

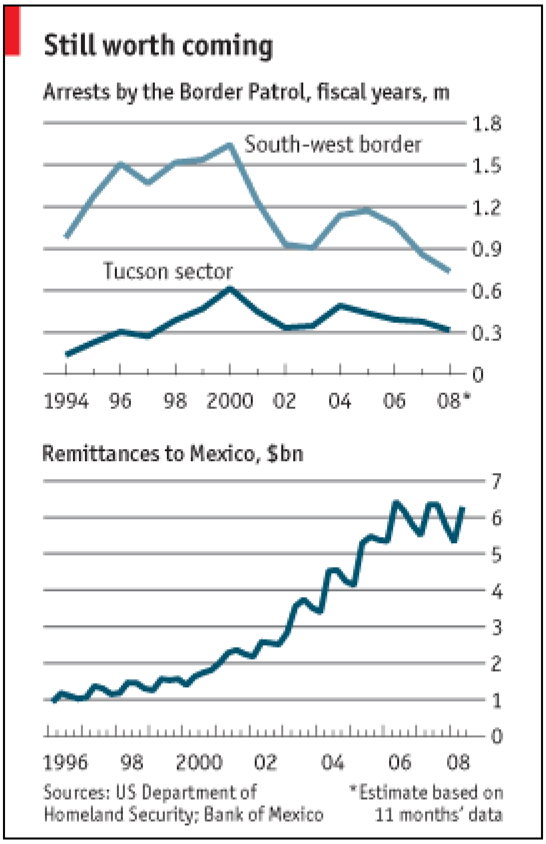
The fence is behind schedule and well over budget, and the network of electronic watchtowers is even further from deployment. But enough has been built, strengthened and staffed to make it clear what kind of border the next president will inherit. America is creating a barrier that is at once much too porous and rather too tight.

Until fairly recently the western half of the US-Mexican border was largely abstract. “As far as the eye can reach stretches one unbroken waste, barren, wild, and worthless,” wrote John Russell Bartlett, who surveyed the area for the American government in the 1850s. The border was marked at first by piles of stones, then by concrete obelisks. Over time the occasional barbed-wire fence went up, but the border was permeable. “You could ride your bike across it,” says Michael Gomez, who grew up five blocks from the border and is now mayor of Douglas, Arizona.

Before the early 1990s those who wanted to cross illegally generally headed for the cities of Tijuana and Juárez. They would wait until night, scale the puny fence and dash for San Diego and El Paso. It was a simple matter of outnumbering the Border Patrol. Then, beginning in 1993, taller fences began to go up in the busiest sections of California and Texas. The assumption was that physical barriers would stop crossers in the cities, and geography would stop them elsewhere.

The first assumption turned out to be correct: between 1994 and 2000 the number of apprehensions around San Diego plunged by two-thirds. The second did not. Rather than giving up, immigrants converged on the border's thinly-policed midsection, braving sun and snakes on long hikes through the desert. In the late 1990s the number of apprehensions shot up in the 260-mile Tucson sector (see chart). So did deaths. Raquel Rubio-Goldsmith of the University of Arizona reckons 125 people died trying to cross the desert in the 1990s. Since 2000 the death toll has been more than 1,000. By contrast, fewer than 300 people died attempting to cross the Berlin Wall in its 28-year history.

As illegal immigrants began to funnel through Arizona, attitudes hardened. In 2004 the state's voters approved a measure intended to deny public benefits to illegals. It was reminiscent of an initiative that Californians had supported in the previous decade, when their state was the central conduit for immigration. Two years later Janet Napolitano, Arizona's Democratic governor, harried the federal government into sending National Guard troops to the border. In 2007 she signed a law stepping up penalties on businesses that knowingly employed illegal workers.



Even political moderates have become advocates for the border fence. Arizona's senior senator is a good example. John McCain has long been an advocate for "comprehensive" immigration reform—Washington-speak for a bill that would allow some illegal immigrants to become citizens. In the past few months, though, he has insisted that the border must be sealed first. Mr McCain's change of heart was probably necessary to get him through the Republican primaries. Yet it is also in harmony with the more strident tone of public opinion in his home state.

Opinions are more nuanced closer to Mexico. David Walker, whose family owns a ranch that spans ten miles of the Arizona-Sonora border, describes the fence as "kind of a Band-Aid". The new pedestrian fence that edges his property has stemmed the flow of immigrants but not stopped it. By means of ladders, blow-torches and screwdrivers, immigrants are still getting through. They drop litter, which is harmful ("Cattle are dumb—they'll eat plastic water bottles") and break cisterns trying to get fresh water. But Mr Walker regards such things as fairly minor nuisances.

He is more concerned about the drug-traffickers who once tried to run him over. So are others. "I'm not a bit afraid of the little Mexicans coming across the border to work," says one woman who runs a ranch near the border. "It's the drug lords that worry me." She is right to be worried.

New Tijuana moods

Though the drug trade and the violence that goes with it have long been features of the border, the past few years have seen both a rise in violence and a change in its nature. The decision of Felipe Calderón, Mexico's president, to use the army against drug-trafficking gangs has led to an arms race and provoked turf wars along the border, from Tijuana to Matamoros. The city of Nogales, Sonora (across the border from Nogales, Arizona) has seen 72 murders so far this year, compared with 44 in 2007.

Despite talk of a united front, the Mexican authorities are divided over how to tackle the problem. Marco Antonio Martinez Dabdoub, the mayor of Nogales, reckons the federal government ought to be more heavy-handed. "This should be like the famous surge in Baghdad," he says. Yet Arturo Ramirez Camacho, the head of Nogales's police force, says that the deployment of the army has served only to provoke more violence. It has been hard to replace the 188 officers who have been sacked for corruption.

So far the surge of violence in Mexican border towns has been largely confined to the narcos and the police. One journalist in Nogales estimates that all but one of the murders so far this year have involved someone connected with the drug trade. Alvaro Navarro Gárate, who is in charge of promoting economic development for the city of Juárez, south of El Paso, says the violence has not yet deterred economic investment. Although some executives fret about being kidnapped, the lack of infrastructure is more off-putting.

The rise of organised crime has, however, changed patterns of illegal immigration. Ten years ago people-smuggling was a casual, low-margin business—a “mom-and-pop” operation, as locals call it. As crossing the border became harder, and the coyotes’ fees rose from about $500 to more than $2,000, the cartels saw a chance for profit. Many of those who traipse through western Arizona these days do so at the pleasure of the Sinaloa cartel, which also runs drugs across the border (although rarely at the same time as people). Its henchmen can be brutal and dishonest, but they are also pretty good at their jobs.

Counting fish in the sea

The fence is undoubtedly changing patterns of illegal immigration. But is it staunching the flow? The Border Patrol points to the fact that they are catching fewer people. Yet this is a very imperfect measure, rather like estimating the number of fish in the sea from those hauled up in fishermen’s nets. The figures do not count those who make it, and they double-count people who keep trying. Remittances to Mexico (see chart above) provide a better picture. These were rising until recently, largely because immigrants began to send more money through formal channels. Now they are falling, but not by much.

For more than ten years, Wayne Cornelius of the University of California at San Diego has been surveying people in high-emigration areas of Mexico. He finds that fewer than half of all would-be illegal immigrants are apprehended on any given trip, and virtually all get through eventually. Mexicans keep trying even though they know the border has become more dangerous. In an unpublished study, Mr Cornelius reports that more than 30% of Oaxacans who plan to steal across the border know somebody who has died trying.

There is a more obvious reason for the recent slowdown in illegal immigration. Construction and landscaping jobs, a common source of employment for Latino immigrants both legal and illegal, have disappeared as the housing market has collapsed. In the past year the Hispanic unemployment rate has risen from 5.4% to 8.0%. Among Hispanics aged 16 to 19 the rate is 22.8%. This deters would-be workers from crossing the border and curtails the ability of people already in America to pay for their relatives to make the trip.

Even if tougher border enforcement has slowed the movement of people, this is not quite the good news it seems. Until recently Mexicans crossed back and forth across the border as work and family demanded. Many years ago Mr Walker’s ranch employed a couple of “wetbacks” (the term was not so derogatory as it is today) who would work half a year each, returning to their families in the off-season.

These days, says Ms Rubio-Goldsmith, migration is not circular but linear. If people come they tend to stay, because the cost and difficulty of crossing the border have increased so steeply. They are more likely to bring their families: in the Sonoran desert, says Mr Johnston, about a quarter of the immigrants are women and children. As immigrants put down deep roots in America, villages in Oaxaca that once lacked young men are becoming utterly depopulated. The border fence may be deterring illegal immigration, but it is not reducing the number of illegal immigrants. It is also annoying people.

Not neighbourly

Ten years ago a group of mayors and other officials on both sides of the line formed the Texas Border Coalition. At first it promoted infrastructure projects, but it is now focused on fighting the fence, which almost everyone in South Texas opposes. They say that it is not neighbourly, that it will be a waste of money, and that it will cut Texans off from the Rio Grande, which marks the border in much of the state.

Texas's two Republican senators are keener on the fence, but not much. Kay Bailey Hutchinson wrote an amendment to a spending bill that allowed the Department of Homeland Security greater latitude to decide where it should run. Hardliners argued that this was a way of "gutting" the more specific Secure Fence Act of 2006. The state's other senator, John Cornyn, insists that despite voting for the Secure Fence Act, he doesn't think it will be built.

Such coolness, which may seem strange in such a politically conservative state, is partly a product of economics. During the first half of this year almost 80% of all US-Mexican trade by value passed through Texas. The state's border towns have benefited from NAFTA, which was signed 15 years ago. In July unemployment in the McAllen area was 7.8%, down from 25% in 1990.

Texans' sanguine attitude is also a matter of demography. When the last census was taken, in 2000, Arizona, California and Texas were all between one-quarter and one-third Hispanic. But their border regions look utterly different. Arizona, which is currently America's fastest-growing state, has experienced a wave of white immigrants—the Midwestern "snowbirds"—who have little experience of Latino culture. Its four border counties were 34% Hispanic in 2000. California's two border counties, which are thick with retirees and military families, were just 28% Hispanic. Texas's border counties, by contrast, were 85% Hispanic.

Margaret Dorsey, an anthropologist from the University of Pennsylvania who studies Texas's Lower Rio Grande Valley, says many local families can trace their roots to the mid-18th-century Spanish land-grant programme. Border Texans often speak fluent Spanish and have family and friends on the other side of the river. Students commute from Mexico to the university in El Paso, crossing in a special line that allows them to make it to class on time. They even pay instate tuition rates.

That would be unthinkable in Arizona, where the fence is broadly popular. Yet Arizonans have plenty of gripes about the tightening border. Increasingly, the problem is less the ease of illegal immigration than the difficulty of legal migration.

Roughly three-quarters of people who cross legally from Mexico into Arizona do so in order to shop. As a result, streets close to the fence have become emporiums for things that are more expensive or harder to come by on the other side. That means handbags and children's clothes on the American side, pharmaceuticals and beer on the Mexican side. Because most twin towns are bottom-heavy (Nogales, Arizona has just 20,000 inhabitants, compared with 190,000 in Nogales, Sonora), American towns depend a lot more on Mexican shoppers than the other way around.

Jaime Fontes, the city manager of Nogales, Arizona, reckons Mexican visitors account for roughly 65% of all retail sales in his city. As border officers become more finicky about documents and more zealous in searching vehicles, he worries trade will suffer. Local businessmen say it already has. Chang Lee, who runs a clothes shop just north of the border, explains in fluent Spanglish that Mexicans are spending "too mucho time" waiting to cross, which leaves too little time for shopping. They come running into his shop, clutching fistfuls of bills and begging him to sell them something before they have to return. He estimates that trade has fallen 20-30% in the past year.

In Douglas, the number of vehicle passengers crossing during the first half of this year averaged 321,000 a month—down from 708,000 a month in the first half of 2002. There are more pedestrians, but pedestrians do not buy as much. Manufacturing firms that have set up *maquilas* in Mexico are suffering too. Two years ago a group of economists calculated that delays at the Tijuana border were costing San Diego County and Baja California more than $4 billion each year.

The tortilla curtain

Over time such gripes are likely to become louder, while complaints about illegal immigration will probably become more muted. Hispanics are slowly acquiring political heft to match their large presence in America; in some states, such as California and New Mexico, they are already powerful enough to punish tough talk. Perhaps more important, Mexico is changing. The country has zoomed towards a first-world birth rate. In the late 1970s the average woman could expect to give birth to five children; now

she gives birth to two. As a result, the potential supply of border-crossers will gradually drop.

Yet they will not stop coming. If the Mexican border is, in the old expression, a “tortilla curtain”, it is still floppy enough to allow people and drugs through. A truly impregnable border, of the kind that Mr McCain is demanding, would involve two layers of fencing 2,000 miles long, with a large no-man’s land in the middle and plenty of watchtowers. The fence would have to look as it does near San Diego, or as it used to in Berlin. This would involve virtually rasing several towns.

Travelling through Texas in the 1850s, Bartlett encountered plenty of immigrant workers. They found employment in the copper mines for the same reason they now toil in America’s building sites and lettuce fields:

“Labour is cheap and abundant in Mexico. At El Paso, Mexican labourers could be had for sixty-two and a half cents per day, they finding themselves; but men could doubtless be procured at even less price.”

While the wage gap between America and Mexico persists, Mexicans will continue to “find themselves” in the American labour force, fence or no fence.

The Economist's poll of economists

Examining the candidates

Oct 2nd 2008 | WASHINGTON, DC
From The Economist print edition

In our special report on the election we analyse the two candidates' economic plans. Here, we ask professional economists to give us their views

Illustration by S. Kambayashi

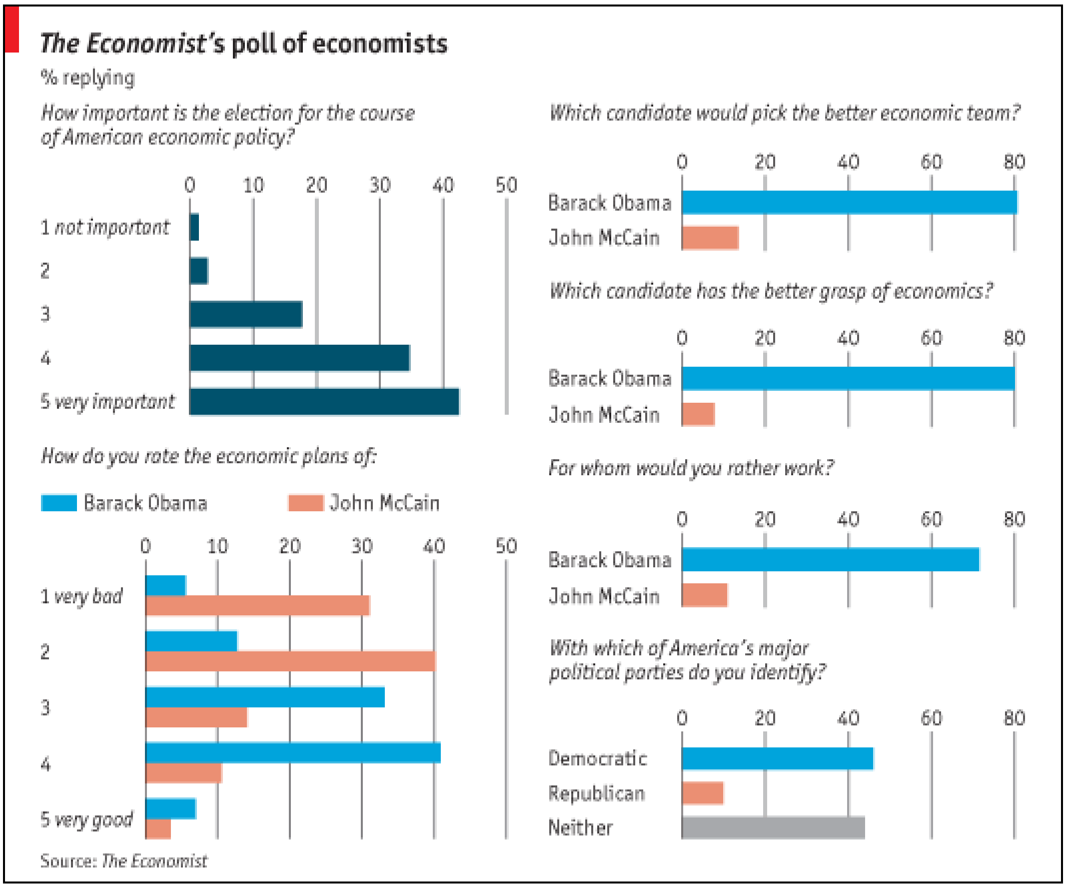
AS THE financial crisis pushes the economy back to the top of voters' concerns, Barack Obama is starting to open up a clear lead over John McCain in the opinion polls. But among those who study economics for a living, Mr Obama's lead is much more commanding. A survey of academic economists by *The Economist* finds the majority—at times by overwhelming margins—believe Mr Obama has the superior economic plan, a firmer grasp of economics and will appoint better economic advisers.

Our survey is not, by any means, a scientific poll of all economists. We e-mailed a questionnaire to 683 research associates, all we could track down, of the National Bureau of Economic Research, America's premier association of applied academic economists, though the NBER itself played no role in the survey. A total of 142 responded, of whom 46% identified themselves as Democrats, 10% as Republicans and 44% as neither. This skewed party breakdown may reflect academia's Democratic tilt, or possibly Democrats' greater propensity to respond. Still, even if we exclude respondents with a party identification, Mr Obama retains a strong edge—though the McCain campaign should be buoyed by the fact that 530 economists have signed a statement endorsing his plans.

Does their opinion matter? Economics is just one of the many things the next president will have to worry about; voters still seem to prefer Mr McCain on foreign policy. And even on the economy, economists may not have the same priorities as the population at large. Arguably, what a president says about economics on the campaign trail is less important than how he responds to the unexpected challenges that inevitably arise once he is in office.

Yet economists' opinions should count for something because irrespective of any party affiliation, most of them approach policy decisions with the same basic tool kit. Their assessment of the candidates' economic credentials and plans represents an informed judgment on how well they will handle difficult trade-offs between efficiency, equity, growth and consensus-building.

Regardless of party affiliation, our respondents generally agree the economy is in bad shape, that the election is important to the course of economic policy and that the housing and financial crisis is the most critical economic issue facing America.



The detailed responses are bad news for Mr McCain (the full data are available here). Eighty per cent of respondents and no fewer than 71% of those who do not cleave to either main party say Mr Obama has a better grasp of economics. Even among Republicans Mr Obama has the edge: 46% versus 23% say Mr Obama has the better grasp of the subject. "I take McCain's word on this one," comments James Harrigan at the University of Virginia, a reference to Mr McCain's infamous confession that he does not know as much about economics as he should. In fairness, Mr McCain's lower grade may in part reflect greater candour about his weaknesses. Mr Obama's more tightly managed image leaves fewer opportunities for such unvarnished introspection.

A candidate's economic expertise may matter rather less if he surrounds himself with clever advisers. Unfortunately for Mr McCain, 81% of all respondents reckon Mr Obama is more likely to do that; among unaffiliated respondents, 71% say so. That is despite praise across party lines for the excellent Doug Holtz-Eakin, Mr McCain's most prominent economic adviser and a former head of the Congressional Budget Office. "Although I have tended to vote Republican," one reply says, "the Democrats have a deep pool of talented, moderate economists."

There is an apparent contradiction between most economists' support for free trade, low taxes and less intervention in the market and the low marks many give to Mr McCain, who is generally more supportive of those things than Mr Obama. It probably reflects a perception that the Republican Party under George Bush has subverted many of those ideals for ideology and political gain. Indeed, the majority of respondents rate Mr Bush's economic record as very bad, and Republican respondents are only slightly less critical.

"John McCain has professed disdain for 'so-called economists', and for some the feeling has become mutual," says Erik Brynjolfsson, a professor at the Massachusetts Institute of Technology Sloan School of Management. "Obama's team is mainstream and non-ideological but extremely talented."

On our one-to-five scale, economists on average give Mr Obama's economic programme a 3.3 and Mr McCain's a 2.2. Mr Obama, says Jonathan Parker, a non-aligned professor at Northwestern's Kellogg School of Management, "is a pragmatist not an ideologue. I expect Clintonian economic policies." If, that is, crushing federal debt does not derail his taxing and spending plans.

On his plans to fix the financial crisis, Mr Obama averages 3.1, a point higher than Mr McCain. Still, some said they didn't quite know what they were rating—reasonably enough, since neither candidate has

produced clear plans of his own.

Where the candidates' positions are more clearly articulated, Mr Obama scores better on nearly every issue: promoting fiscal discipline, energy policy, reducing the number of people without health insurance, controlling health-care costs, reforming financial regulation and boosting long-run economic growth. Twice as many economists think Mr McCain's plan would be bad or very bad for long-run growth as Mr Obama's. Given how much focus Mr McCain has put on his plan's benefits for growth, this last is quite a repudiation.

Mr McCain gets his highest mark, an average of 3.5 and a clear advantage over Mr Obama, for his position on free trade and globalisation. If Mr Obama "would wake up on free trade", one respondent says, "I could get behind the plans much more." Perhaps surprisingly, the economists rated trade low in priority compared with the other issues listed. Only 53% say it is important or very important. Neither candidate scored at all well on dealing with the burgeoning cost of entitlements such as Medicare and Social Security.

The economists also prefer Mr Obama's tax plans. Republicans and respondents who do not identify with either political party see Mr McCain's tax policies as more efficient but less equitable. But the former prefer Mr McCain's plans—43% of Republicans say they are good or very good—and the latter Mr Obama's. Of non-affiliated respondents, 31% say Mr Obama's are good or very good.

Either way, according to the economists, it would be difficult to do much worse than George Bush. The respondents give Mr Bush a dismal average of 1.7 on our five-point scale for his economic management. Eighty-two per cent thought Mr Bush's record was bad or very bad; only 1% thought it was very good.

The Democrats were overwhelmingly negative, but nearly every respondent viewed Mr Bush's record unfavourably. Half of Republican respondents thought Mr Bush deserves only a 2. "The minimum rating of one severely overestimates the quality of Bush's economic policies," says one non-aligned economist.

This is the fourth presidential election in which *The Economist* has surveyed economists on the candidates and their plans. Responses, anonymous except where requested, were received between September 18th and 30th. For full results see article.

Bail-out politics, continued

While Wall Street burns

Oct 2nd 2008 | WASHINGTON, DC
From The Economist print edition

Lawmakers fiddle, then reach for the fire-hose

WHEN Congress does nothing, Americans usually breathe a sigh of relief. But when the House of Representatives failed to pass a rescue package for the financial system on September 29th, panic ensued. The stockmarket crashed: more than a trillion dollars in paper wealth evaporated in a single day. That, plus the shock waves that battered markets around the world, seems to have made lawmakers sit up and take notice.

Before the vote, Barney Frank, the Democratic head of the House banking committee, observed that: “It is hard to get political credit for avoiding something that hasn’t yet happened.” Perhaps that is why the rescue plan was rejected, by 228 votes to 205. Some lawmakers simply weren’t convinced that disaster was imminent if they failed to act.

George Bush and his treasury secretary, Hank Paulson, were asking them for $700 billion to buy up distressed mortgage-related assets. The aim was to shore up the financial system and avert a collapse that might starve the whole economy of credit. But to many in Congress, it sounded like spending a colossal fortune to spare rich bankers from the consequences of their recklessness. Angry phone calls from voters convinced them that the public saw it that way, too.

So the House said no; 140 Democrats voted for the bill while 95 voted against it. Among Republicans, it was 133 against and only 65 for. Despite their own president begging them to vote yes, two-thirds of Republicans told him to get stuffed. The market duly collapsed. Voters who previously thought Wall Street was not their problem suddenly noticed that they had just lost a big chunk of their retirement savings, and called their representatives to complain. And despite a recovery in the stockmarket, their representatives seem to have decided that they need to do something.

On October 1st, the Senate passed a revised version of the bill by the healthy margin of 74 votes to 25. John McCain and Barack Obama both flew back to Washington to vote for the bill. Both spoke in its favour, warning that a failure to act would invite calamity. Although taxpayers should eventually recoup some or even all of the bill’s cost, both candidates admitted that it might affect their fiscal plans. Mr McCain promised a freeze on all non-essential spending. Mr Obama said he might delay some of his spending plans, but excluded his tax cuts, health-care reform, infrastructure investment, alternative energy and education. That is, all the main items on his wish-list bar expanding the armed forces.

Reuters

The bill must now go back to the House, which was tentatively scheduled to vote again on October 3rd. Having been burned once, House leaders are unlikely to call the vote unless they are sure it will pass. The optimists among them note that only 12 representatives need to change their minds. And the bill has been sweetened to woo waverers.

At the suggestion of both Mr Obama and Mr McCain, the Senate made federal insurance for bank deposits more generous to reassure nervous depositors. It will now cover the first $250,000 anyone holds at any bank, up from the previous ceiling of $100,000. The bill also includes $100 billion of assorted tax breaks and handouts, though some lawmakers deem this irresponsible given the swelling deficit.

Lawmakers had various reasons for voting “no” the first time round. Several Democrats said they did not trust Mr Bush to spend the money wisely, and in any case would have preferred it to be spent directly on homeowners struggling to avoid foreclosure. Several Republicans wanted a cheaper package that gave the government less power to meddle in the

market.

Some naysayers will stick to their guns, but some will surely decide that circumstances demand a little flexibility in applying their principles. And the speaker of the House, Nancy Pelosi, whose bizarre speech supposedly in favour of the bill on September 29th sounded more like a call to wait until the next administration, may feel a greater sense of urgency.

A message to Congress

The election campaign

Heard on the stump

Oct 2nd 2008
From The Economist print edition

Illustration by KAL

Garage sale
"We figured that instead of protesting this plan, we'd give regular Americans the same opportunity to sell their bad assets to the government."

A website allows Americans to offer unwanted items to Hank Paulson. Buymyshitpile.com

Mark of the beast
"I was just curious if there was any validity to it. I was trying to get documentation if there was any Scripture to back it up."

A mayor in Fort Mill, South Carolina circulated an e-mail suggesting that Barack Obama was the Antichrist. Charlotte Observer, *September 28th*

They might be giants
"It's very important when you consider even national security issues with Russia as Putin rears his head and comes into the airspace of the United States of America, where, where do they go? It's Alaska. It's just right over the border."

Mrs Palin explains her foreign-policy experience. CBS, September 25th

Damn you, liberal media
"I was a little disappointed the media called it a tie but I think that means, when they call it a tie, that means we win."

Mr McCain reflects on the response to the debate. Reuters, September 27th

Blue-plate special
"A crap sandwich."

Minority leader John Boehner's real opinion of the bail-out bill. Politico.com, September 28th

Someone needs a hug

"It's Sunday, I'm tired, Senator Obama did well."

Senator Lindsey Graham, a McCain advocate, can't be bothered to spin the post-presidential-debate polls. Fox News Sunday, September 28th

Tyranny of youth
"I've never met him before. But I've been hearing about his Senate speeches since I was in, like, second grade."

Sarah Palin, 44, jabs at Joe Biden's age. Mr Biden is six years younger than John McCain. CNN.com, September 29th

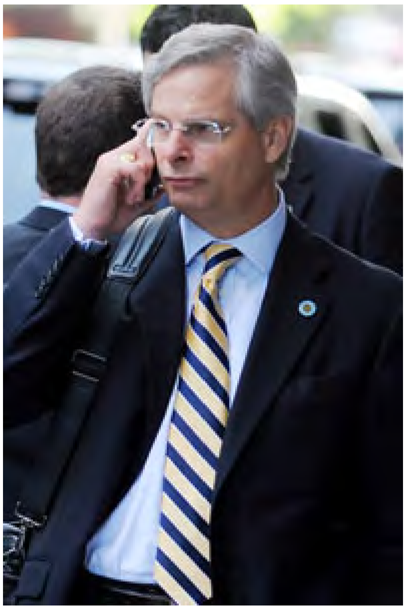
Lobbyists and the election

The war over lobbyists

Oct 2nd 2008 | WASHINGTON, DC
From The Economist print edition

Or, pots denouncing kettles

AP



Who's calling Rick Davis?

LOBBYING in America is at least as old as the country's constitution. In 1792 veterans of the American revolution hired William Hull to petition Congress for more compensation. These days fat-walleted lobbyists get much of the blame for gridlock and corruption in Washington, and both presidential candidates have made fighting "special interests" a central theme of their campaigns.

Barack Obama does not let his audiences forget that he will not hire or take money from lobbyists. But he cheerfully collects donations from lobbyists' relations, lobbyists can volunteer to advise his campaign, and he rakes in tens of millions of dollars from lawyers. Mr Obama has certainly taken cash from lobbyists in the past; in a recent ad, John McCain cites Mr Obama's previous connections to influence-peddlers such as the disgraced Tony Rezko in Chicago. He also accuses Mr Obama of taking more money from executives at Fannie Mae and Freddie Mac, the two giant mortgage companies that have just been taken over by the government, than any member of Congress save one.

But Mr McCain has more former Fannie and Freddie lobbyists working for him, including Rick Davis, his campaign manager, and Charlie Black, his chief strategist. Mr Davis has come under particular fire, because it was recently discovered that his lobbying firm continued to take money from Freddie Mac until as late as August. Mr Davis no longer works for the firm, but he has shares in it. In fact, Mr Obama points out, seven of Mr McCain's senior advisers are former lobbyists. This week the blogosphere debated which candidate had spent more time gambling with lobbyists in off-hours. Pots are denouncing kettles all round.

Presidential candidates are by no means the only politicians with ties to the lobbying world. Nearly half of all retiring congressmen have gone into lobbying in recent years, as have many high-level staffers. Some see this "revolving door" as a clear sign that those who employ lobbyists are buying undue influence.

Perhaps, but it shows even more clearly that some of the most experienced hands in politics work on Washington's K Street, the centre of the lobbying universe. Lobbyists have unique expertise and terrific networks. Try to run a big political campaign—or go for the White House—without them, and you dry up the pool of talent from which you can draw.

A team packed with ex-lobbyists is not bad in itself. The problem arises when politicians side with powerful lobbies against good sense. Both Mr Obama and Mr McCain may be cleaner than others on Capitol Hill—a low bar indeed—but both have also voted with or bowed to big lobbies. Mr Obama supported the farm bill, a vast government giveaway to agribusiness. Over the summer, groups such as the Club for Growth successfully hounded Mr McCain into opposing an increase in taxes of any kind to shore up America's pensions system, even though he had wanted to keep all options open days before. And when the race got tight, both campaigns discovered they could tolerate outside spending groups—the sorts of special interests they denounce—running nasty ads on their behalf.

Both candidates promise to change Washington. But the imperatives of politics, which requires lots of money and foot-soldiers, haven't changed yet.

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UNITED STATES

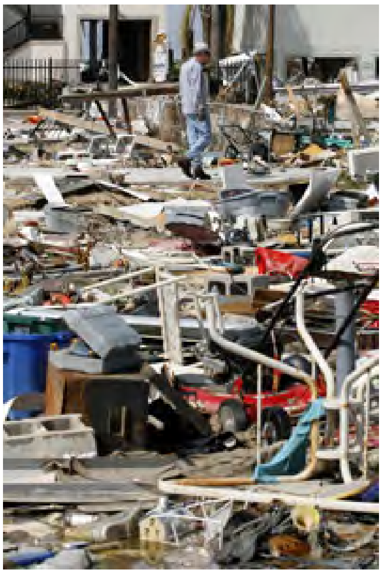
After the storm

Politics and petrol problems

Oct 2nd 2008 | AUSTIN
From The Economist print edition

The Gulf coast is still recovering from hurricane season

AP



They don’t like Ike

THE end of September saw a crisis on Wall Street and a garbled response from Congress. No wonder, then, that all eyes were trained on New York and Washington. But the south-eastern states were dealing with more immediate problems: petrol panics, property damage and missing people. The Gulf coast was hit by two hurricanes in September, Gustav and Ike. Neither was catastrophic, as forecasters had feared. But they were bad enough.

In Georgia, North Carolina and Tennessee, petrol was the issue. Most of the Gulf of Mexico’s crude-oil production halted before Gustav, and after the hurricanes hit the refineries were slow to recover. As of September 29th, according to the Department of Energy, more than half of production was still shut down. Two pipelines serve most of the south-east, and severe shortages resulted. People started to fill up whenever they could, sometimes queuing for hours. Newt Gingrich, the former speaker of the House, said that in Atlanta and Charlotte and Chattanooga the situation was “like a third-world country.” People contemplated public transport and telecommuting.

In Louisiana the agriculture commissioner estimated that Gustav, which hit on September 1st, had caused at least $372m in damage to crops. Almost half of the state’s cotton, for example, had been ruined. The fishing industry also took a hard knock, with tens of millions of dollars in damage to boats, docks and processing plants. The National Guard was trying to help cattle producers on the coast, using helicopters to ferry hay and water to animals left stranded by the floodwaters.

But the most pressing problems were in Texas, where Ike made landfall on September 13th. Two weeks later hundreds of people were still missing, mostly from the coastal communities of Galveston, Crystal Beach and Port Bolivar. Rescuers hoped that many would be found, but were fearful that some had been swept out to sea or buried in piles of debris.

As the search went on, life was ticking back to speed in Houston, 50 miles (80km) inland. Power was mostly restored by the end of the month. People rescued hundreds of baby squirrels that had been knocked from trees and nursed them with bottles of milk. Contractors acknowledged that much of the rebuilding work would fall to illegal immigrants. Texan officials went to the Senate to ask for federal aid. Insurers and officials fear Ike’s damage to Texas could exceed $50 billion.

The clearest sign that things were returning to normal was that people resumed talking politics. The mayor of Houston, Bill White, is considered a strong Democratic candidate for governor in 2010. The incumbent, Rick Perry, plans to run for re-election. He may face a challenge in the Republican primary from the state’s senior senator, Kay Bailey Hutchison. On September 25th she announced that she would not seek re-election to one of her Senate committee assignments because she wants to “explore new opportunities that many Texans have asked me to consider.” Mr Perry’s spokesman suggested that he was too busy with Ike business to think about his political ambitions.

There was also a flap when Mr Perry and Sonny Perdue, the Republican governor of Georgia, joined forces to scold Mr White. The mayor had sworn at volunteers when he realised that trucks full of supplies were sitting idle while some of the distribution centres around the city were empty. Mr Perry helpfully offered his apologies on behalf of the state of Texas. Mr White apologised in a written response: “I did use words that I have never used in the Sunday school class I teach.” Most Texans saw no need for contrition. After all, Mr White got the trucks moving.

Swing states: Florida

A struggle in the sunshine

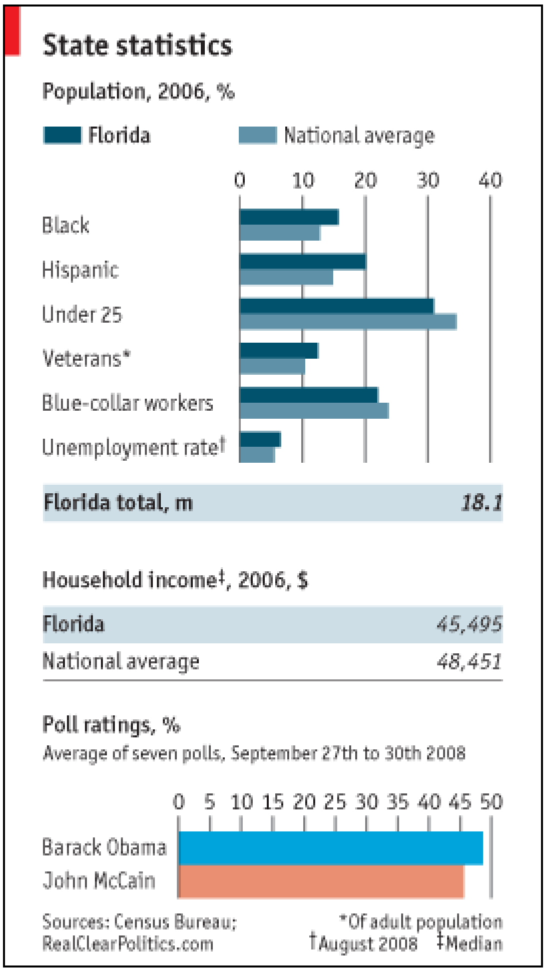
Oct 3rd 2008 | MIAMI
From The Economist print edition

John McCain has to win Florida, but may not

FUGITIVES from every hellhole on earth packed the hall. There were 417 Cubans, 95 Haitians, nine Brits and one Somali. In all, some 1,200 new citizens put their hands over their hearts and swore their first oath of loyalty to America. Then they cheered and hugged and cried and waved little flags. And when the ceremony ended and they wandered joyfully out of the building, campaign workers for Barack Obama and John McCain pounced on them and urged them to register to vote.

Olga Willis, a lady from Russia with a fabulous gold handbag, signed up at the McCain booth. Stalin murdered her great-grandfather and dumped several of her relatives in the snow in Siberia, she says, so she is none too keen on socialism. “Barack Obama says he will take from those who have too much. What is too much?” she asks. Mrs Willis, who left Russia nine years ago, is married to an American and works as a mortgage-broker. She asks the McCain volunteers if they have some bumper-stickers. They offer her one. She asks for another, because “we have two cars.”

Florida is a must-win state for Mr McCain. Without its 27 electoral votes, he is all but certain to lose in November. Until very recently, most polls put him narrowly ahead in the state, but his lead has been shrinking fast. Several polls have now put him behind and by October 2nd the much-followed average compiled by RealClearPolitics had Mr Obama three points ahead. This is truly dreadful news for the Republican. One reason may be that Mr Obama has enthused legions of new voters. There are 250,000 more registered Florida Democrats now than in January, but the Republicans have gained only 80,000, out of an electorate of nearly 11m. If previously apathetic young people and blacks turn out in droves, Mr Obama could easily win.



Yet the Sunshine State is seldom predictable, as Americans learnt during the recount in 2000. Before the second world war Florida was a mosquito-infested backwater. Thanks to air-conditioning, its population increased tenfold to 18m, making it the fourth-largest state. The newcomers are a colourful mix of Latinos, pensioners (many of them “snowbirds” who come south for the winter) and working families drawn by warm weather, low taxes and a booming economy.

Floridians who fled leftist despots tend to vote Republican. Bettina Rodriguez Aguilera, a McCain volunteer, describes how Fidel Castro’s thugs tried to grab her and bundle her off to a school in the Soviet Union when she was three years old. “[Barack Obama] thinks he can just sit down with Castro and [Venezuelan autocrat Hugo] Chávez. Maybe he doesn’t understand the real world,” she says.

By the second or third generation, however, memories of oppression grow dimmer. Dan Smith, a politics professor at the University of Florida, says he often encounters Cuban-American students who plan to vote Democratic but dare not tell their grandparents.

Having boomed for so long, Florida’s economy is now ailing. Inward migration has slowed, house prices are collapsing and the foreclosure rate is one of the highest in America. Workers fear for their jobs; retirees are nervous about their pensions. None of this helps Mr McCain.

“I’m from the South, so I should be prejudiced, but I’m going to vote for Obama,” says Scott Carden, a retired military man. His pension is secure but his investments are not, he says. After only two months in Florida he has already had a heart attack, which he jokingly blames on “stress from worrying about Bush”. He does not know whether Mr Obama has the experience to be president, but he dismisses Mr McCain as a man who stands for “whatever Bush wants” and who “picked some idiot out of Alaska to be his vice-president”.

Mr Obama plans to spend a whopping $39m in Florida—nearly half as much as Mr McCain can spend for the whole country, though that excludes cash spent by the Republican Party on his behalf. And the Obama ground operation is larger than anything Lance DeHaven Smith, a professor of politics at Florida State University, has ever seen. An Obama staffer in Miami admits that his candidate is sometimes a hard sell. His Utopian slogans remind some recent immigrants of the dictators they fled. But the Obama campaign is fighting hard for every vote.

And fighting pretty dirty. One of Mr Obama’s television ads warns, falsely, that Mr McCain plans to cut public pensions in half. Another spot, in Spanish, suggests that Mr McCain is a bigot. The ad blames “John McCain and his Republican friends” for the failure of immigration reform, and implies that he agrees with Rush Limbaugh, a rabble-rousing talk-show host who once referred to “stupid, unskilled Mexicans”. In fact, Mr McCain was one of the two main sponsors of immigration reform, a brave stance that earned him the enmity of Mr Limbaugh.

Mr Obama hardly has a monopoly on smear tactics, though. The Florida Republican Party, for its part, warns that an Obama victory will leave America vulnerable to terrorists and force Floridians into a system of socialised medicine. Such is the critical importance of Florida, now much more competitive than expected, that many outsiders have entered the fray. Mr Obama’s offices teem with helpers from out of state. Unions, church groups and single-issue enthusiasts of all stripes are campaigning hard. And Sarah Silverman, a comedian, urges her fellow Jewish-Americans to make “the great schlep” down to Florida and get their grandparents to vote for Mr Obama—unless, she says, they don’t want any more visits.

Lexington

Reaping the whirlwind

Oct 2nd 2008
From The Economist print edition

George Bush's presidency is ending in disaster

Illustration by KAL

PLENTY of people can be blamed for the calamity on Capitol Hill on September 29th. Two-hundred and twenty-eight congressmen decided they were ready to risk another Great Depression. Nancy Pelosi made an idiotic speech damning the Republicans. Sheriff McCain claimed that he was going to ride into town to sort out the mess—and promptly fell off his horse. But there is no doubt where the lion's share of the blame belongs: with George Bush. The dismal handling of the financial crisis over the past fortnight is not only a comment on Mr Bush's personal shortcomings as a leader. It is a comment on the failure of his leadership style over the past eight years.

The convenient excuse for Mr Bush's performance is that he is at the fag-end of his presidency. Public attention has shifted to the presidential candidates, and the members of the House face the electorate in a month. But this rings hollow: there is nothing about the political cycle that dictates that an outgoing president should have an approval rating of 27% and an army of enemies on Capitol Hill. Bill Clinton ended his two terms with ratings of close to 70%.

The crisis underlined Mr Bush's two biggest personal weaknesses—his leaden tongue and his indecisiveness. He failed to explain in simple language that a crisis on Wall Street also means a crisis on Main Street. The self-styled decider was also singularly lacking in decisiveness. He handed responsibility for the bail-out to a technocrat, his treasury secretary, Hank Paulson, but then failed to provide him with the necessary political backup. He started lobbying legislators only days before the vote. He failed to travel to Capitol Hill to make a personal appeal to Congress. Worse still, he wasted political capital on a farcical photo-op meeting in the White House with the presidential candidates. Mr Clinton would have done things a lot better.

Catastrophe will probably be averted, at least for now. As *The Economis*t went to press, it looked as if the rescue package would pass through the House of Representatives, perhaps as early as October 3rd: it was approved by the Senate on October 1st. But this was less thanks to the Bush administration than to the fact that a run on the markets has put the fear of God into legislators. Moreover, the collapse of the rescue package was part of a wider pattern of failure: almost everything that the Bush administration has attempted since 2004, most notably Social Security reform and immigration reform, has ended in failure.

This succession of failures is a verdict on Mr Bush's leadership style. The Bush administration has been

defined by two things—ruthless partisanship and an iron commitment to presidential power. In his first term Mr Bush pushed through a conservative agenda of huge tax cuts and a war against Iraq despite the fact that he had the narrowest of mandates. In his re-election bid in 2004 he relied on supercharging the conservative base rather than reaching out to middle-of-the-road voters.

The Bush administration also treated Congress with something approaching contempt. Mr Bush liked to think of himself as a CEO at the head of a government machine rather than as a politician in a town of politicians. The first directive that his vice-president, Dick Cheney, gave to his chief counsel, David Addington, was to "restore the powers of the presidency". This contempt was unconcealed when it came to the Democrats (Joe Lieberman excepted): Mr Cheney even told Vermont's Patrick Leahy to "go fuck yourself" on the Senate floor. But it extended to fellow Republicans. The White House nonchalantly undermined one Senate majority leader, Trent Lott, because it thought that it could replace him with a more pliable one, Bill Frist. It failed to keep Congress informed about important decisions, particularly on the "war on terror", let alone involved in decision-making.

The Bush legacy

This my-way-or-the-highway partisanship destroyed Mr Bush's ability to push through entitlement reforms. Why should the Democrats take the risk of helping to change the system when Mr Bush was likely to take all the credit for success? It also destroyed his ability to win enough Democratic support for one of the most important bipartisan measures he championed, immigration reform. On September 29th Mr Bush saw his rescue package torn apart by two groups of people who have been enraged by his political style—left-wing Democrats (who regard him as the spawn of Satan) and right-wing market fundamentalists. He also saw Congress relishing the chance to humble the imperial presidency. "This is a democracy," remarked North Dakota's Kent Conrad. "This isn't a dictatorship."

Mr Bush also paid the price for the defining cause of his presidency, the invasion of Iraq, an initiative which destroyed the bipartisan unity created by September 11th, 2001. The most stinging complaint against the Emergency Economic Stabilisation Act of 2008 was that it bore an uneasy resemblance to the Iraq War Resolution of 2002. There was the same bid for untrammelled authority (Mr Paulson's initial request for $700 billion was a mere three pages; Congress has expanded it to 450 pages); the same alarmist rhetoric ("our entire economy is in danger"); and the same insistence that Congress should act immediately. Sceptics battered the president with complaints about crying wolf.

The most damning verdict on Mr Bush this week came not from the Democrats but from the 133 Republicans who decided to vote against a Republican administration. Mr Bush devoted much of his energy as president to forging a lasting Republican majority. But over the past four years conservatives have turned against him on everything from immigration reform to financial management. Far from creating a hegemonic party, Mr Bush leaves the Republicans in the worst state they have been in for decades; riven by divisions, confused about their identity and facing Armageddon at the ballot box.

Latin America's economies

Keeping their fingers crossed

Oct 2nd 2008 | SÃO PAULO
From The Economist print edition

In Latin America, the most trenchant opponents of globalised finance look most likely to suffer at its hands

Illustration by Claudio Munoz

IF ANALOGIES with the Great Depression are scary for Americans, they are hardly less so for Latin Americans. Within a few years of the 1929 stockmarket crash, 16 governments in the region fell to military coups or takeovers by strongmen. In recent years the talk has mostly been of Latin America's economic independence from its big neighbour in the north (with the exception of Mexico). But on September 29th, the day the House of Representatives in Washington balked at the bail-out, came a reminder of just how close those ties still are. While the Dow Jones dropped by nearly 7% in a day, Brazil's Bovespa, the region's biggest stockmarket, tumbled by more than 9%.

Even so, the fact that this financial crisis does not have "made in Latin America" stamped on it is cause for modest celebration. In the crises of 1994, 1998 and 2001 Latin America went on a binge, using foreign finance to pay for a huge rise in imports. The mood then changed, foreign money fled and panic ensued. This time many countries have had trade surpluses in recent years, and soaring commodity prices have made government finances look more than respectable (see chart).

Latin American banks also look strong. This is partly because they did not hoover up American mortgage-backed securities, but also because they are not that dependent on foreign credit. Brazil's banks are an exception: the publicly traded small and medium-sized banks that do depend on foreign funding have had their share prices pummelled over the past week. But even in Brazil, foreign capital accounts for only about 10-20% of bank-funding needs.

Equity markets in Latin America are shallow (apart from in Brazil), which reduces the chances of one path of infection. Credit is more of a concern, particularly for exporters, who are finding foreign lines of credit much harder to acquire. This may be only a temporary blip. But if it endures, companies will turn to domestic lenders instead, leaving less credit to go around. Edmar Bacha of the Banco Itaú, who has seen many crises come and go, says a credit squeeze is now his chief concern.

A bigger future fear, though, is that a global slowdown accompanied by a decline in commodity prices will put government finances under pressure. Chile, which pours money into a big fund (currently around $20 billion) when copper prices are high, and bases its budget on a copper price far below the current spot price, is the only big country in the region where the commodity boom has not been accompanied by a government spending spree. Commodity prices have already fallen back a bit. If they fall much further some countries will be in trouble.

Heading the list of those most vulnerable are countries whose markets have been viewed for some time as badly behaved: Venezuela, Argentina and Ecuador. Venezuela, which has given up producing things that its consumers want, importing them instead on the back of its oil revenues, looks particularly exposed. The same oil revenue has allowed the number of public-sector jobs to more than double since President Hugo Chávez came to power in 1999, and is also underwriting a big new arms deal with Russia. Cutting public spending is an option, but not one which he would wish to contemplate before critical regional elections at the end of November. Even then it may not be easy to switch into austerity mode. Despite a recent increase in the arrests of “foreign imperialist plotters”, Mr Chávez would find it hard to explain away large numbers of people descending onto the streets.

If lower commodity prices lead to lower costs of staple foods, this would provide Argentinians with some relief against their country’s rampaging inflation. But for President Cristina Fernández’s government it would be a different story. It gets 10% of its revenue from export taxes. A fall in commodity prices would squeeze farmers (who already pay a 35% tax on exports) even more and might reignite their recent protests. Ms Fernández might be tempted to make up the shortfall by raiding pension funds. There is also a currency concern. The peso, which has won back trust after its crash in 2001, is backed by high soyabean prices. If these fall, it could lead to a fresh flight to dollars for those able to get them, and misery for everyone else.

For well-behaved countries, such as Mexico, Brazil, Colombia and Peru, things look better. Their governments have balanced their budgets and built up trade surpluses along with dollar reserves. In some places growth is still strong: the latest year-on-year figures show an 8.3% rise in Peru for July, and 6.1% rise in Brazil for the second quarter. Not everyone is convinced by this rosy picture. “Economists who talk about structural shifts on the eve of a cyclical downturn should all be taken outside and shot,” says Gray Newman of Morgan Stanley, a bank.

Meanwhile, Mexico’s age-old linkage to the United States’ economy is already having an effect. In August remittances from Mexicans working north of the border suffered their biggest drop on record. Hopes that Americans will keep buying heroic quantities of Mexican manufactured goods are dimming. And Mexico’s trade balance, boosted by high oil prices, is at risk. Brazil, Latin America’s biggest economy, looks better placed. But commodities account for about half its exports, leaving it, too, vulnerable to a fall in prices.

The biggest difference this time around, it seems, is that those countries that have been most hostile to global capitalism look the most exposed to its changed mood. In the 1930s, the region’s democracies suffered from a crash and a depression made thousands of miles away. Today, it is the elected monarchies ruled by economic populists who have the most to fear.

Ecuador's new constitution

In good faith

Oct 2nd 2008 | QUITO
From The Economist print edition

Though not as radical as similar reforms in Venezuela and Bolivia, Ecuador's newly approved charter could still spell trouble

AP

Oh joy! Correa grabs more power

Get article background

ON SEPTEMBER 28th Ecuadorians voted by an almost two-thirds majority (64%) to approve a new constitution—Ecuador's 20th since independence—giving President Rafael Correa sweeping new powers and the possibility of remaining in office until 2017. This, he says, will consolidate his "citizens' revolution" and bring stability to this chronically unstable Andean nation that has had eight presidents in the past 11 years. But many Ecuadorians worry that the left-wing populist president is creating a Venezuelan-style autocracy.

In championing the new constitution, Mr Correa has certainly followed the path of two fellow leftist presidents, Hugo Chávez of Venezuela and Evo Morales of Bolivia. The three share an antipathy towards neoliberalism and central-bank autonomy, along with a belief in state-owned businesses, the welfare state and a redistribution of wealth—made easier in all three countries by the surge in energy prices.

Like Venezuela's constitution, approved by a similarly big majority of voters in 1999, Ecuador's seeks to create a new "people's power", giving an appointed citizens' council oversight of the other branches of government. It also allows a president to hold office for two consecutive four-year terms, instead of just one. (After extending the time Venezuela's president could remain in office to two consecutive six-year terms, Mr Chávez failed in his attempt to remove all limits.)

But Ecuador's constitutional reforms are much less radical than those already introduced in Venezuela and now planned in Bolivia (where, after violent protests last month, the government and opposition have been locked in talks). Unlike Messrs Chávez and Morales, Mr Correa, an economist educated in the United States, has not moved to nationalise telecommunications and electrical utility companies, or vowed to establish closer relations with Russia. Nor, despite the fears of big landowners, has he threatened to seize their properties.

Mr Correa says that his charter needs to be interpreted "in good faith", and might even require some correcting. The article calling for the redistribution of the means of production, for example, should be understood as seeking equal opportunities for all, he insists. One clause even calls for the state to maintain price stability. "We want a society of entrepreneurs," says Gustavo Larrea, the security minister.

After the expulsion of America's ambassadors to Venezuela and Bolivia, Mr Correa hastened to say that he would not be following suit. Indeed, only heavy campaigning had kept him from meeting the United

States’ new ambassador to Ecuador, who arrived in August.

The referendum is Mr Correa’s fourth straight victory at the polls in the past two years. But the new constitution is already causing tensions. Hours after the vote, hundreds of would-be squatters tried to invade a nature reserve in Guayaquil, Ecuador’s biggest city—the 19th such attempt—claiming their action was now permitted under the new charter. They managed to clear two-thirds of the newly reforested site before being evicted.

Meanwhile, in Quito, the capital, Ecuador’s 31 Supreme Court judges are up in arms over plans to turn their court into a smaller 21-member National Court of Justice and subject its authority to a new Constitutional Court. Some have threatened to resign, with the possibility of leaving Ecuador with a big gap in its legal system for many months. And these are only the first of the obstacles likely to confront the “citizens’ revolution”.

Afghanistan

Talking to the Taliban

Oct 2nd 2008 | LASHKAR GAH, HELMAND
From The Economist print edition

In the battle for hearts and minds, the Taliban are compromising core principles

Landov

THE mood in Kabul has been a gloomy one of late, with little sign that NATO forces are any closer to winning the war against the Taliban. On the front-line in Helmand there is equally little sign that the Taliban are winning the fight either. Instead there are signs that the organisation is adapting to broaden its popular appeal.

The British army, leading the NATO effort in Helmand, has lost 115 soldiers there since 2006, compared with perhaps 5,000 dead Taliban. Yet Qari Yusuf Ahmadi, a senior Taliban spokesman, is relentlessly upbeat: “We struggle for almighty Allah and we are sure we are winning.” The outgoing British commander, Brigadier Mark Carleton-Smith, credits the Taliban with being “still tactically quite resilient and certainly quite dangerous”. But he says the British are “minimising the objective damage” they are able to inflict.

Given the military stalemate, the British strategy now focuses on developing Afghan forces and government structures with a view to an eventual political solution. Brigadier Carleton-Smith estimates Britain can start withdrawing troops in three to five years. But Afghan political maturity could take “decades or generations”.

In the past year the Taliban have lost territory, notably the towns of Garmser and Musa Qala, the only two places in Afghanistan where they defended fixed positions. Now their strategy appears to rely less on controlling territory than on expanding influence. So, to court greater support from the warily ambivalent Helmand population, they have eased some of their resented social edicts. Bans on music, television, kite-flying, dog-fighting and even the shaving of beards have all been lifted.

There are also persistent reports of the Taliban offering amnesties to government officials and police who defect, even when they are captured in combat. Immediate execution used to be the norm. Some locals seem won over by the new approach. Others think it merely a tactic. Haji Salim Khan, a tribal elder from Musa Qala, sniffs that the Taliban are being “so nice” only to find out who their friends are, “then they impose their law.” Another compromise has been the Taliban’s accommodation with drug-farmers and -smugglers. This autumn Taliban commanders have promised to defend the poppy fields in the previously pro-government districts of Nad Ali and Marja—a delicate matter, given the Koran’s prohibition of drug

use.

"It is lies that drug money comes to us," insists "Mullah Mujahed", a 23-year-old Taliban commander. But he does acknowledge that the Taliban accepts *zakat*, alms, from the local poppy-farmers. This buys arms and ammunition, usually from corrupt Afghan police and soldiers, and mitigates the Taliban's long supply lines.

Resilient though the Taliban are proving, their internal dynamics seem to be changing. "Mullah Ahmed", a distinctly weary older Taliban commander, says that half the Taliban are "respectable" God-fearing people. But the other half are robbers or people who bring "personal enmities" into the Taliban.

Since 2001 NATO has managed to kill many trusted members of the old Taliban leadership. The replacements are less well-known quantities. Mullah Mujahed may just have been promoted to command his own "*mahaz*", or front-line, a rank roughly equivalent to a Western major. He says the average age for such a promotion is now just 25. Where they can, the Taliban replace dead leaders with their nearest relative. This helps maintain loyalty in a group obsessed about "spies". But it reinforces tribalism. Indeed, some analysts now see the Taliban in Helmand as to some extent a tribal force, representing particular groups excluded from power since 2001.

Historically, the Taliban's strengths were their Islamic credentials, their reputation for imposing law and order and their opposition to tribal factionalism. If those three weaken, it is harder to distinguish them from the myriad other tribal militias that have long plagued Afghanistan.

Indonesia's army

Going out of business

Oct 2nd 2008 | JAKARTA
From The Economist print edition

And, with luck, retreating from politics

AFP

How green was their money

REFORMING Indonesia's army, once among the world's most corrupt and abusive, has been a slow process since the army-backed Suharto regime collapsed ten years ago. A big obstacle to this, and to the country's democratic progress, has been the forces' deep involvement in all sorts of businesses, legal and illegal. The income from these sidelines—including plantations, logging, hotels and property development—gave the army an unhealthy degree of independence from the civilian government that supposedly oversees it. With much of the revenue being diverted into senior officers' pockets, it also allowed them to keep meddling in politics, even after they were stripped of their guaranteed seats in parliament in 2004.

A law passed that same year instructed the army to surrender its businesses to the government by October 2009. Not much happened until earlier this year, when President Susilo Bambang Yudhoyono (himself a liberal ex-general) created a panel of experts to investigate the firms. The panel is due to report to the president this month. The defence minister, Juwono Sudarsono, says it has identified about 1,500 military firms. But most have gone bust, been bought by the private sector or are close to collapse. Only six viable firms with assets over $50,000 have been found.

The businesses date back to the struggle for independence from the Netherlands in the 1940s. Each unit of the nascent Indonesian forces had to finance itself and any method—even smuggling and drug-trafficking—was acceptable. Under Suharto the businesses became huge money-spinners. Many were disguised as "foundations" for the welfare of lower ranks but were really vehicles for the chiefs' money-laundering and other capers. Recently they have crumbled, as Indonesia's economy has been progressively liberalised and they lost the monopolies they relied on.

The government panel's findings concur with those of a recent study by Lex Rieffel and Jaleswari Pramodhawardani for the Brookings Institution, an American think-tank. It found that by 2006 the combined revenues of Indonesia's military businesses had shrivelled to $185m at most, and put their profits at no more than $73m. These figures are much smaller than military experts had hitherto assumed, and are a fraction of that year's official defence budget of $2.9 billion. Even so, the Brookings study reckons it will be tough to persuade senior officers to give them up while most other arms of the state have their own sidelines.

The findings undermine one of the army chiefs' main excuses for keeping their businesses: that they desperately need the revenues to supplement the meagre official budget. Mr Sudarsono agrees that although the defence budget has now been raised to $3.6 billion, it remains inadequate; he compares this sum, spent to defend a nation of 226m people, with the $4.6 billion that tiny Singapore spends to defend

5m people. He believes he has, however, convinced the top brass that spending on public works and anti-poverty schemes must take priority for the next five to ten years, and that by thus building a stronger economy the government will eventually have more money to spend on defence.

Polls show that the army's reputation among the public has improved. Cases of corruption and abuse still continue (such as in the troubled Papua region) but there is nothing like the top-down organised repression of the Suharto years. A few military strongmen associated with those abuses, such as Prabowo Subianto (son-in-law of the late dictator) and Wiranto, a former army chief, are campaigning for next year's presidential election, perhaps financed from their past business earnings. But their poll ratings are low. Various other ex-military men are running for parliamentary seats but Pramono Anung, the general secretary of the main opposition Indonesian Democratic Party of Struggle, says he sees no sign of a concerted attempt by the army to return to politics.

The problem, notes Tim Huxley of the International Institute for Strategic Studies, a think-tank, is that, as the army's image has improved, that of the police has sunk. The police have taken on many of the bad characteristics once associated with the army: corruption, abuses and running illegal sidelines. Mr Sudarsono says that, though the army has officially given up its role in public security, some local authorities still call on it to deal with unrest because they mistrust the police.

Pakistan's Inter-Services Intelligence

Both sides against the middle

Oct 2nd 2008 | ISLAMABAD
From The Economist print edition

Getting Pakistan's spies to stop dabbling in jihad

THE Inter-Services Intelligence directorate (ISI), Pakistan's notorious military spooks, deserve credit for the audacity of their covert support for the Taliban, the enemy of Pakistan's greatest ally. But America's patience with the ISI's double-dealing in Afghanistan is running thin. Pakistan's president, Asif Ali Zardari, has given assurance that he will tame the ISI. But a civilian with a dodgy past will find it hard to tackle what Pakistanis call Invisible Soldiers Inc.

In July the prime minister, Yousaf Raza Gilani, tried to bring the ISI under the control of the interior ministry. His decision was reversed within hours. But the army chief, General Ashfaq Kayani, who has said the ISI is trying to purge itself of pro-Taliban elements, has appointed a new ISI chief, General Ahmed Shujaa Pasha, to replace a loyalist of the former military ruler, Pervez Musharraf. The appointment, part of a broader top-brass shuffle, consolidates General Kayani's grip on the army. General Pasha has supported his chief's efforts to withdraw the army from politics and to fight militants on the Afghan-Pakistan border.

The ISI helped round up hundreds of al-Qaeda fighters after September 11th 2001. It has been the target of terrorist attacks and has picked up senior Taliban commanders at NATO's behest. But it has never kicked the old habit of using the Taliban and other jihadist militants to keep alive Pakistani ambitions in Afghanistan and Indian-controlled Kashmir.

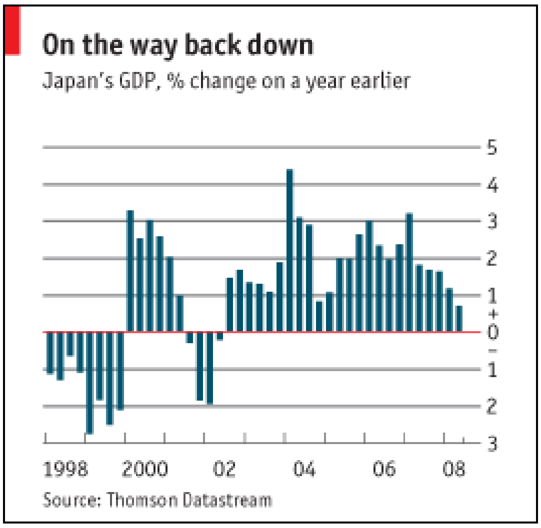
American officials believe that the ISI's agents tip off militants ahead of missile strikes. They claim it was involved in the bombing in July of the Indian embassy in Kabul; and that it supports Soviet-era veterans such as Jalaluddin Haqqani, who is believed to have close ties to al-Qaeda. Asked about demands for the ISI to be reformed, Mr Zardari replied: "We don't hunt with the hound and run with the hare, which is what Musharraf was doing." The trouble is, he is not the master of the hunt.

Japan's slowing economy

Unbouncy Aso

Oct 2nd 2008 | TOKYO
From The Economist print edition

Global turmoil roils Japan’s politics



WHEN Congress first voted down a bail-out of America’s banking system, any residual hope swiftly vanished among Japan’s ruling clique that the country could float over the top of the credit turmoil troubling the rest of the developed world. Certainly the banks are sound, having recovered from Japan’s own harrowing financial crisis in the 1990s. They and other firms are even seizing the moment to snap up cheap businesses overseas (see article). So the chief concern—for now, at least—is Japan’s export-driven economy, which appears fast to be running out of puff. This concern has shot to the top of the agenda for Taro Aso, the prime minister of all of a week. It will probably dictate when he will call a general election, in which the long dominance of the ruling Liberal Democratic Party (LDP) is at stake.

After six years of economic expansion Japan may now be in full-blown recession. The expansion was driven by exports, which are now falling to America and to Europe; Japan’s carmakers’ shipments to America have fallen by nearly a third. Only in Asia are exports holding up, though eyes are on China, where some industries, such as construction, a big buyer of Japanese steel, are looking shaky.

The export slowdown is hitting company profits. So are recent rises in the price of imported materials, hurting Japan’s terms of trade. Now that the price of oil has fallen from its peak, the terms of trade should improve. But Japanese companies are gloomy. On October 1st the Bank of Japan’s quarterly Tankan survey of business sentiment reported a bleaker mood among manufacturers and non-manufacturers, large and small. In particular, plans for investment have been cut back. Small and medium-sized companies report difficulties raising funds. So a turnaround in real wages, which have been falling this year, is hard to imagine. Household spending will remain depressed.

Against this backdrop, Mr Aso wants to pass a stimulus package worth ¥12 trillion ($115 billion, though little of it is new spending), putting off till later the business of bringing down Japan’s staggering levels of national debt. More economists now agree with him. The package will pass the lower house of the Diet (parliament) around October 7th and go to the upper house, controlled by the opposition Democratic Party of Japan (DPJ). Since coming to office, Mr Aso has adopted a more adversarial tone towards its bruising leader, Ichiro Ozawa, than did his two predecessors.

It had been assumed that Mr Aso this week would call a snap election for early November, something both Mr Ozawa and the LDP’s junior coalition partner, New Komeito, want. But the stalled bail-out in America increased the urgency of the stimulus package, making Mr Aso pause. As Yasuhiro Nakasone, a former prime minister, puts it: it would hardly do for the world’s second-biggest economy to be without a government at this crucial moment, along with the world’s biggest.

The DPJ has long opposed the stimulus, arguing that it serves the LDP’s vested interests. It planned to sit on the bill in the upper house and use the current Diet session to grandstand on other issues. Only after 30 days, according to the constitution, would the bill then become law, but Mr Aso would not be able to dissolve the Diet in the meantime. Perhaps the DPJ will be prodded by a sense of duty to vote sooner. In that case the bill would become law however the upper house votes, while freeing Mr Aso to call an election. Mr Aso is now thinking of waiting until he can prepare a set of budget proposals to take to the country later this year, as well as create a promised consumer-affairs agency.

That might make tactical sense to Mr Aso. His new cabinet has not enjoyed the hoped-for bounce in opinion polls. Careless talk quickly claimed one minister. Nor was the prime minister, who introduced his

cabinet to the emperor on September 24th, helped by Junichiro Koizumi. The next day the long-maned former prime minister, who dominated the scene from 2001 to 2006, announced his retirement from politics. Mr Nakasone notes dryly that Mr Koizumi always excelled at performances that stole the limelight, and his resignation was no exception. Mr Aso pointedly excluded Koizumi reformists from his cabinet, but the Lionheart's going sets his followers in the LDP free to commit no end of trouble, even treachery, in the days after the election Mr Aso will eventually call.

Privatisation in South Korea

Against the tide

Oct 2nd 2008 | SEOUL
From The Economist print edition

One government at least still plans to sell its assets rather than buy more

PRIVATISATION was to be the hallmark of the administration of Lee Myung-bak, who became South Korea's president in February. This month he will at last unveil his plans to whittle down the number of state-owned companies to about 250 from 319. The government wants to sell more than 35 companies outright or in stages, abolish others and merge another 20. Mr Lee had hoped to sell even more state assets. But consumers' fears about price rises forced him to set aside the sale of electricity, gas and water companies.

Global markets are in turmoil, the Seoul stockmarket is plunging and Mr Lee's approval ratings are not much above 25%. But his office, backed by an opinion poll in August, claims a majority of voters support the plan. South Korea's three biggest newspapers also all back his agenda of "small government and big market".

The passage of more than 40 privatisation bills through South Korea's parliament will be rocky. The president's own Grand National Party (GNP) holds a comfortable majority in the National Assembly. But it struggled to pass a supplementary budget last month designed to stimulate the economy. Assemblymen have to heed their constituents, many of whom fear Mr Lee's economic agenda favours the wealthy at the expense of the poor. A bill that raises the threshold above which homes attract property taxes to 900m won ($770,000) is making its way through parliament. It has been criticised as a sop to Mr Lee's supporters in Seoul's wealthy southern districts.

South Korea's public-sector unions are likely to be bitter opponents of Mr Lee's privatisation programme. Lee Wang-hwi, a professor of political science at Ajou University, near Seoul, points out that South Korea's trade unions are unusual in that those representing public-sector and financial workers are more aggressive than the manufacturing unions.

Plans to sell state-owned banks such as Korea Development Bank (KDB) have come under increased scrutiny thanks to Wall Street's financial crisis and KDB's efforts to acquire Lehman Brothers just before it went bankrupt. KDB had hoped to make itself a Wall Street powerhouse by buying a leading investment bank at a fire-sale price. But in an embarrassing revelation, the finance minister, Kang Man-soo, told parliament he hadn't been told of KDB's plans to buy Lehman.

Cho Yoon-sun, a GNP spokeswoman, says Wall Street's meltdown should give the president pause in his privatisation plans. The sale of KDB and other firms taken over in the country's financial crisis of 1997-98 will probably be stretched out over the remainder of Mr Lee's term. But if his asset-selling drive is to gather momentum, he will have to win over his own party, which might demand a degree of political skill that he has yet to exhibit.

Christianity in China

Sons of heaven

Oct 2nd 2008 | BEIJING AND SHANGHAI
From The Economist print edition

Inside China’s fastest-growing non-governmental organisation

EPA

Jesus loves you

ZHAO XIAO, a former Communist Party official and convert to Christianity, smiles over a cup of tea and says he thinks there are up to 130m Christians in China. This is far larger than previous estimates. The government says there are 21m (16m Protestants, 5m Catholics). Unofficial figures, such as one given by the Centre for the Study of Global Christianity in Massachusetts, put the number at about 70m. But Mr Zhao is not alone in his reckoning. A study of China by the Pew Forum on Religion and Public Life, an American think-tank, says indirect survey evidence suggests many unaffiliated Christians are not in the official figures. And according to China Aid Association (CAA), a Texas-based lobby group, the director of the government body which supervises all religions in China said privately that the figure was indeed as much as 130m in early 2008.

If so, it would mean China contains more Christians than Communists (party membership is 74m) and there may be more active Christians in China than in any other country. In 1949, when the Communists took power, less than 1% of the population had been baptised, most of them Catholics. Now the largest, fastest-growing number of Christians belong to Protestant “house churches”.

In a suburb of Shanghai, off Haining Road, neighbours peer warily across the hallway as visitors file into a living room, bringing the number to 25, the maximum gathering allowed by law without official permission. Inside, young urban professionals sit on sofas and folding chairs. A young woman in a Che Guevara T-shirt blesses the group and a man projects material downloaded from the internet from his laptop onto the wall. Heads turn towards the display and sing along: “Glory, Glory Glory; Holy, Holy, Holy; God is near to each one of us.” It is Sunday morning, and worship is beginning in one of thousands of house churches across China.

House churches are small congregations who meet privately—usually in apartments—to worship away from the gaze of the Communist Party. In the 1950s, the Catholic and main Protestant churches were turned into branches of the religious-affairs administration. House churches have an unclear status, neither banned nor fully approved of. As long as they avoid neighbourly confrontation and keep their congregations below a certain size (usually about 25), the Protestant ones are mostly tolerated, grudgingly. Catholic ones are kept under closer scrutiny, reflecting China’s tense relationship with the Vatican.

Private meetings in the houses of the faithful were features of the early Christian church, then seeking to escape Roman imperial persecution. Paradoxically, the need to keep congregations small helped spread the faith. That happens in China now. The party, worried about the spread of a rival ideology, faces a difficult choice: by keeping house churches small, it ensures that no one church is large enough to

threaten the local party chief. But the price is that the number of churches is increasing.

The church in Shanghai is barely two years old but already has two offspring, one for workers in a multinational company, the other for migrant labourers. As well as spreading the Word, the proliferation of churches provides a measure of defence against intimidation. One pastor told the *Far Eastern Economic Review* last year that if the head of one house church was arrested, "the congregation would just split up and might break into five, six or even ten new house churches."

Abundant church-creation is a blessing and a curse for the house-church movement, too. The smiling Mr Zhao says finance is no problem. "We don't have salaries to pay or churches to build." But "management quality" is hard to maintain. Churches can get hold of Bibles or download hymn books from the internet. They cannot so easily find experienced pastors. "In China", says one, "the two-year-old Christian teaches the one-year-old."

Because most Protestant house churches are non-denominational (that is, not affiliated with Lutherans, Methodists and so on), they have no fixed liturgy or tradition. Their services are like Bible-study classes. This puts a heavy burden on the pastor. One of the Shanghai congregation who has visited a lot of house churches sighs with relief that "this pastor knows what he is talking about."

Still, the teething troubles of the church are minor compared with the vast rise in the number of Christians. After the Tiananmen Square massacre of 1989 many disenchanted democrats turned to Christianity: six of the 30 or so student leaders of the protests became Christians. China's new house churches have the zeal of converts: many members bring their families and co-workers. One Confucian Chinese says with a rueful smile that most of the pretty girls at university were Christians–and would date only other Christians.

Holier and trendier than thou

Christianity also follows Chinese migration. Many Christians studied in America, converted there and brought their new faith home. Several of the congregation of the Shanghai house church studied abroad, as did Mr Zhao. In 2000, says one Beijing writer and convert, most believers were in the countryside. After 2000 they brought their faith into the cities, spreading Christianity among intellectuals.

All this amounts to something that Europeans, at least, may find surprising. In much of Christianity's former heartland, religion is associated with tradition and ritual. In China, it is associated with modernity, business and science. "We are first-generation Christians and first-generation businessmen," says one house-church pastor. In a widely debated article in 2006, Mr Zhao wrote that "the market economy discourages idleness. [But] it cannot discourage people from lying or causing harm. A strong faith discourages dishonesty and injury." Christianity and the market economy, in his view, go hand in hand.

So far, Christianity's spread has been largely a private matter for individual believers. The big question is whether it can remain private. The extent of its growth and the number of its adherents would suggest not. But at the moment, both Christians and Communists seem willing to let a certain ambiguity linger a while longer.

"Christians are willing to stay within the system," says Mr Zhao. "Christianity is also the basis for good citizenship in China." Most Christians say that theirs is not a political organisation and they are not seeking to challenge the party. But they also say clashes with public policy are inevitable: no Christian, one argues, should accept the one-child policy, for example.

Formally, the Communist Party forbids members to hold a religious belief, and the churches say they suffer official harassment. The president of the Beijing house-church alliance, Zhang Mingxuan, was thrown out of the capital before the Olympic games and told he was unwelcome when he returned. In early June, the state government of Henan arrested half a dozen house-church members on charges of illegally sending charitable donations to Sichuan earthquake victims. CAA claims harassment of house churches is rising.

In fact, the state's attitude seems ambivalent. In December 2007, President Hu Jintao held a meeting with religious leaders and told them that "the knowledge of religious people must be harnessed to build a prosperous society." The truth is that Christians and Communists are circling each other warily. But it is hard to avoid the conclusion that Christianity will have a political impact one day. "If you want to know what China will be like in the future," concludes Mr Zhao, "you have to consider the future of Christianity

in China."

China's online vigilantes

Virtual carnivores

Oct 2nd 2008
From The Economist print edition

Struggling to protect privacy behind the great firewall

Illustration by Claudio Munoz

UNTOLD legions police the internet in China to block information deemed politically threatening. But the world's biggest online population still has a wild streak. Worries are growing about internet vigilantes who mount "renrou sousuo", or "human-flesh searches", to ferret out perceived wrongdoers.

Zhou Zhenglong, a peasant in the north-western province of Shaanxi, began a 30-month jail term on September 27th after internet-users exposed his faking of photographs of a rare Chinese tiger in the wild. Senior Shaanxi officials, eager to attract tourists to the area, had backed the pictures' authenticity for several months. They were eventually fired amid an internet outcry. Some posters on Chinese bulletin boards and blogs have argued that Mr Zhou was perhaps merely a hapless tool in a hoax perpetrated mainly by bureaucrats.

In the absence of a free press in China, the internet, despite attempts at censorship, can sometimes put the brakes on official abuses of power. But it can also go too far. As the state-run news agency, Xinhua, put it, "You may find yourself up before a kangaroo court of angry netizens and receive a virtual lynching." "Human-flesh searching" is known less dramatically in English as "crowdsourcing"—using inputs from a large number of people (usually internet users) to solve problems. But often in China the practice involves mobilising people online to hunt down ordinary citizens whose only alleged sin is that of being objectionable.

One of the first well-publicised examples occurred in 2006 when pictures of a well-dressed woman killing a kitten with her stiletto heel were posted on the internet. Outraged human-flesh searchers discovered she was a nurse in the north-east. Her name and place of work were posted online, along with personal details of others involved. The woman was sacked. This year human-flesh searchers, outraged by the alleged sympathy of a Chinese student in America for Tibetan separatists, posted her personal details online. Faeces were dumped outside her parents' home in China.

Such incidents have been spurring officials to tighten the law. A draft amendment proposes three years' imprisonment for officials who leak personal data. A Beijing court recently ordered a company to pay a former employee 10,000 yuan ($1,460) for calling him a thief online and asking internet users to track him down. The official press has been highlighting another case in Beijing involving a man whose affair allegedly prompted his wife to commit suicide. Despite online vilification and real-life harassment, he is trying to sue internet sites for defamation. Victims of the internet mob still have a glimmer of hope.

Somalia

The world's most utterly failed state

Oct 2nd 2008 | NAIROBI
From The Economist print edition

The spread of piracy just draws attention to the growing chaos on Somalia's land

Reuters

Get article background

TIPPED off by friends in ports from Odessa to Mombasa, Somali pirates captured a Ukrainian freighter, the *MV Faina*, in the Gulf of Aden and steered it to Somalia's coast. At first they demanded $20m for the release of ship and crew. The captain died, apparently of "hypertension", and several pirates may have then killed each other after a quarrel. This recent incident was only the latest in a long list of similar outrages and highlights the growing menace caused by the total failure of the state of Somalia, the ultimate cause of the virus of piracy in the region.

The ship was carrying 33 T-72 Russian tanks, anti-aircraft guns and grenade launchers. Lighter weapons may have been offloaded on the Somali shore before an American warship arrived on the scene. Kenya claimed ownership of the cargo but the manifest suggests its destination was south Sudan, with Kenya's co- operation in its delivery to be rewarded in the future with cheap south Sudanese oil. At midweek, a Russian warship was steaming to the scene to take responsibility for its citizens on the ship.

The attack was only one of at least 60 off Somalia this year. Foreign navies can intercept vessels captured by pirates, but the desolation and length of Somalia's coastline give them little chance of stamping out piracy without much larger and better co-ordinated forces. In cahoots with gangs in Yemen, Somali pirates look set to go on hitting vessels heading into or out of the Red Sea or passing through the Gulf of Aden: about 10% of the world's shipping.

It is big business. The pirates are increasingly sophisticated, handsomely bankrolled by Somalis in Dubai and elsewhere. They are not yet directly tied up with the Islamist insurgents in Somalia, though they may yet have to pay cash to whoever controls their coastal havens in return for uninterrupted business, thus assisting the purchase of weapons and fuelling the violence. The nabbed ships are mostly anchored off the village of Eyl in Puntland in the north-east or the pirate town of Haradheere farther south (see map) until a ransom is paid, which is usually within a month of capture. The average ransom has tripled since 2007, as has the number of ships taken. Some $100m may have been paid to pirates this year. By comparison, the United Nations Development Programme's annual budget for Somalia is $14m.

Piracy is a symptom of the power vacuum inside Somalia. The country's "transitional federal government", headed by a warlord president, Abdullahi Yusuf, and a bookish prime minister, Nur Hussein, is powerless to stop its citizens raising the Jolly Roger, just as it cannot halt the resurgent jihadists, some with al-Qaeda connections, who have taken control of much of southern Somalia, including the port town of Kismayo. Hundreds of thousands have fled street fighting in the north of Mogadishu to camps outside the city; some head south to refugee camps in Kenya. About 9,000 civilians have been killed in the insurgency in the past year, according to human-rights groups.

The UN's envoy to Somalia, Ahmedou Ould Abdullah, a former foreign minister of Mauritania, is overseeing peace talks in nearby Djibouti between the transitional government and the moderate wing of the Alliance for the Reliberation of Somalia (ARS), an Islamist group headed by a former teacher, Sharif Ahmed. The aim is to create a genuine government of national unity before elections next year.

A condition of any agreement is the withdrawal of the 7,000-odd Ethiopian troops now in Somalia. Mr Ould Abdullah wants to replace them and a separate 2,200-strong African Union force of Ugandan and Burundian troops with 8,000 UN peacekeepers. Ethiopia, which is losing men and money, would be happy with that, if the peacekeepers were somehow shoehorned in without the jihadists taking advantage of a hiatus. America agrees, but only if the deployment of blue helmets is matched by an effort to build a new Somali national army. Mr Ould Abdullah is also keen for the International Criminal Court in The Hague to indict some of the worst warlords, to show they cannot murder their opponents with impunity.

But it is unlikely, in present circumstances, that UN peacekeepers will ever arrive. If the UN cannot produce half its promised force for Darfur, despite a detailed plan for one, Somalia stands little chance of getting any blue helmets at all.

Feuding among Somali leaders makes matters worse. "Somalia is a victim of its political, business and military elite," says Mr Ould Abdullah. "They've taken the country hostage." A slender hope, backed by Britain and some other EU countries, is that ordinary Somalis will eventually force their leaders to put national interest above self-interest and sign the proposed agreement in Djibouti. In any event, says another diplomat, "There is no Plan B."

As the peace talks limp on, the insurgency is getting stronger. It is led by the Shabab (Youth), the armed wing of the Islamic Courts Union, which ran Somalia with some success for a few months in 2006 until it was smashed, at the end of that year, by the invading Ethiopians, with American backing. The Shabab has since reconstituted itself, making ground with tactics copied from Iraq: roadside bombings, the kidnap and murder of foreigners, local aid-workers and peace campaigners, and grenade attacks on video shacks showing films or football.

My enemy's enemy is my friend

Its fighters come under the leadership of a wily red-bearded 70-year-old jihadist, Hassan Dahir Aweys, and a former deputy commander of the Islamic Courts, Mukhtar Robow. They are backed by Eritrea, which has offered sanctuary to the radical rump of the ARS in its capital, Asmara. Eritrea's interest is not to help Somalia but to hurt its bitter enemy, Ethiopia. The Shabab is also backed by fighters from the Hawiye clan and by hungry young freelance gunmen who represent Somalia's huge lost generation. Half the population, 10m-odd before the exodus, was born after Siad Barre's regime fell in 1991. Since then, it is guessed, only 10% have had even rudimentary education; health care barely exists.

Few foreign governments have shown much interest in trying to end Somalia's woes. Diplomats charged with trying to do so are frustrated and depressed. Meanwhile the suffering is mounting. The UN reckons 3.2m Somalis now survive on food aid. The piracy means that warships have to escort ships bringing food. If fighting intensifies, that will be harder—and manipulating food aid could become a weapon, as it was during fighting in 1991 and 1992, when 300,000 Somalis starved to death.

Yemen

Jangling nerves

Oct 2nd 2008 | SANA'A
From The Economist print edition

Resurgent terrorist groups are just a symptom of broader troubles

THE wreckage of twin car bombs outside the American embassy in Yemen's mountain capital, Sana'a, confirmed fears of a resurgent jihadist movement in a strategic country at the foot of the Red Sea, just across from chaotic Somalia. The attack in mid-September was the second on the American embassy in six months. A misfired mortar that hit a nearby girls' school in March had prompted the evacuation of non-essential American staff.

Jittery diplomats had been back at their desks for less than a month when six suicide-bombers blew themselves up outside the embassy compound's gate. American staff promptly packed their bags once again. Yemen's interior ministry rounded up dozens of suspects but is said to be refusing to adopt some of the State Department's suggested extra security measures.

Yemen is an increasingly fragile state, where President Ali Abdullah Saleh tries to neutralise enemies and troublemakers by binding them into loyalty bargains, offering freedom in return for information and good behaviour. Though such surrender-and-release deals for prominent jihadists annoy Western governments, especially America's, Yemeni officials say it is better to entice jihadists back into the fold than tackle them head on.

Be that as it may, al-Qaeda is flourishing in this dirt-poor country. Many Saudi Islamists have fled across their southern border into Yemen to escape tighter controls at home. An influx of experienced insurgents back from Iraq, where al-Qaeda has been hard hit, has pepped up the movement. Yemen's foreign minister, Abu Bakr al-Qirbi, recently told the *Washington Post* there were 1,000-1,500 al-Qaeda and like-minded fighters in the country, both Yemenis and Arabs from elsewhere in the region. Angry young radicals are turning their aggression against an ageing, corrupt regime that gets millions of dollars of direct military finance from the United States.

Since September 2001 Mr Saleh has sought to convince Western allies that he alone can guarantee Yemen's stability. He marked 30 years in power this July by declaring an abrupt end to a four-year civil war in the northern province of Saada. He has also taken the sting out of a southern separatist movement that started with riots on the streets last summer. But sceptics doubt whether this victor's peace will hold. The oil receipts that pay for Mr Saleh's wide network of patronage are dwindling. Yemen is the smallest oil producer in the Middle East and has begun to extract less. State revenues from oil and gas are forecast to plummet in 2009-10 and may dry up by 2017 without big new finds.

Three-quarters of government income comes from energy sales but efforts to diversify the economy by promoting tourism will fail as long as the country is dangerous. Foreign investors are deterred by the insecurity as well as by Yemen's shaky politics. The constitution requires Mr Saleh to step down in 2013, in theory leaving Yemen to face its first ever peaceful transition of power; parliament, however, is pondering an amendment that might extend the 66-year-old's term of office. Party politics is riven with factionalism and feuding; the risk of violence is ever-present.

Foreign aid-givers want drastic reform but lack of political will and the civil service's general incompetence mean frustratingly slow implementation. Food and water shortages, plus burgeoning inflation, are causing widespread disgruntlement, which will worsen if Yemen's population of 22m nearly doubles to 43m by 2035, as some projections suggest. Yemenis manage to struggle along. But with jihadists active and the political succession uncertain, the outlook jangles the nerves.

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Syria and Lebanon

Jihadist blowback?

Oct 2nd 2008 | CAIRO AND TRIPOLI
From The Economist print edition

No one is sure who planted the latest bombs but speculation abounds

Reuters

About as clear as Syrian power-broking

BLOWBACK is what happens when a policy rebounds against its perpetrator. A much-cited example is Afghanistan, where America backed mujahideen insurgents fighting the Soviet Union, only to find them later training their sights on New York. Something similar may be happening in Syria and Lebanon, where recent bombings look likely to be the work of jihadist groups that have turned against their former patrons. Yet the irony in this case is double, because shadowy manipulators in Lebanon and Syria each hoped to turn the jihadists against the other, and because more lately both countries' leaders have been trying to make friends.

As with much that happens in Syria, the details surrounding a car-bombing in Damascus, the capital, on September 27th are obscure. What is known is that a vehicle blew up in the early morning a few hundred metres from two buildings said to belong to Syrian intelligence. The blast killed 17 people, nearly all civilians. It was the most murderous attack in the tightly policed Baathist state since an uprising by Muslim Brothers was crushed in the 1980s.

But the size of the bomb and the timing and location of the blast suggest it may have missed its target. Cryptic reports from the state news agency said the vehicle, a GMC Suburban, had entered Syria "from a neighbouring Arab country" the previous day. Such cars serve as long-distance taxis in Iraq, running regular services for the 1m-plus Iraqis who have taken refuge in Syria, many near the bomb site in Damascus's southern suburbs. The reports said it had been driven by a lone suicide-bomber believed to belong to a known jihadist group. In recent years, several small-scale incidents have been tied to such groups.

The biter is bitten

Fearful of a spillover of sectarian troubles from both Iraq and Lebanon into Syria, an officially secular country with an equally combustible sectarian mix, Syrian authorities have grown increasingly intolerant of jihadists. Recent reports suggest the government has mounted a campaign on the long desert border with Iraq to stamp out cells known to have aided the Iraqi insurgents. The Syrian army has also boosted its presence along the previously unpatrolled Lebanese border, to stem the movement of people and weapons from loosely-policed Lebanon. Unsurprisingly, the jihadists have taken umbrage. "After closing the borders, the Syrians got a message from the Salafists [extreme Sunni jihadists]: you leave us alone or we target you," says a Lebanese spook.

Yet for some time after America invaded Iraq in 2003, Syrian intelligence was widely reckoned to have quietly aided the flow of foreign jihadists to Iraq. Oddly, for instance, a radical Sunni preacher in Syria's northern city, Aleppo, known as Abu Qaqa, was allowed to recruit fighters openly but then declared himself a pacifist in 2004, before being assassinated a year ago. Some suggest that as many as 80% of the foreign fighters who entered Iraq's maelstrom passed through Syria. Until Syrian forces withdrew from Lebanon in 2005, Syrian intelligence also monitored Islamist groups there. Operating chiefly in Palestinian refugee camps and poor Sunni enclaves in Lebanon's north and east, these groups supplied suicide-bombers for Iraq.

But as Iraq has grown less hospitable to al-Qaeda-style jihadists, the human flow has reversed, with many heading back to Lebanon. Last year, a large number of heavily armed men surfaced at Nahr al-

Bared, a Palestinian refugee camp on the edge of Tripoli in northern Lebanon, and took over bases belonging to a Syrian-backed Palestinian faction. Their leader, Shaker al-Absi, an experienced Syrian-based Palestinian fighter who now backs al-Qaeda, had been mysteriously freed from Syrian police custody, despite having been fingered for organising the assassination of an American diplomat in Jordan.

At the same time, anti-Syrian Sunni Lebanese factions in Tripoli, seeking to bolster support against pro-Syrian groups, including the Shia militia-cum-party Hizbullah, had turned a blind eye to the growing influence of Salafist groups in the city. But Mr Absi's men eventually clashed with the Lebanese army, sparking a bloody siege of the camp. People aligned to his faction are believed responsible for a continuing series of revenge attacks on the Lebanese army. In two identical ones in Tripoli in the past two months, roadside bombs have hit buses carrying Lebanese soldiers. One this week killed five soldiers and two civilians. Mindful of such events in Tripoli, Ayman Zawahiri, Osama bin Laden's deputy in al-Qaeda, has approvingly said that Lebanon is now "a Muslim front-line fort".

Radical Sunni Islamists have grown in confidence elsewhere in the country. In another Palestinian camp, outside Sidon, a port south of Beirut, where the regular Lebanese army dares not go, a bearded Sunni bomb-maker boasts of how many times he has travelled to Iraq to wage *jihad*.

But Tripoli has been the hub. In an effort to bring the Sunni extremists into the fold, Saudi Arabia has paid for new mosques there, while Saad Hariri, Lebanon's senior Sunni politician and a moderate, has been criticised for courting Sunni radicals as a bulwark against the rising power of Shia Hizbullah. It is a risky tactic. "Hariri has been paying *jihadis* not to be *jihadis* but they've been rebelling against him," says Nadim Shehadi, a Lebanon expert at Chatham House, a London think-tank. "You don't play Gandhi with a *jihadi*."

In a world of less tangled relationships, the targeting of Lebanon and Syria by jihadists might prompt both governments to co-operate against a joint enemy. But that is still unlikely to happen for a while yet.

Iraq and Afghanistan

Petraeus's next war

Oct 2nd 2008
From The Economist print edition

After success in Iraq, can America's favourite general win in Afghanistan?

AFP

The general plots his next squeeze

IN LESS than two years General David Petraeus has become the most admired American general of recent times. His success in overseeing America's military surge in Iraq, reversing the country's descent into a sectarian bloodbath, has earned him praise from both contenders in America's presidential race. He is a "great general" in the view of John McCain, and has "done a brilliant job" according to Barack Obama. Given his intelligence, ambition and deft handling of the media, the general is talked of as a possible future president.

First, though, he has some more soldiering to do. As he has left Iraq to take over Central Command later this month, presiding over operations from Egypt to Afghanistan, his views will do much to shape the course of the "war on terror" under the next president. He faces a persistent question: can his Iraqi success be replicated in Afghanistan?

As security has improved in Iraq, it has worsened in Afghanistan. And as the surge of forces comes to an end in Iraq, there are calls for a similar one in Afghanistan. In its dying days, the Bush administration has ordered a full review of policy in Afghanistan. General Petraeus took part in lengthy high-level meetings in London and Paris last month, and in August he brain-stormed with Pakistan's top brass on an American aircraft-carrier in the Indian Ocean.

He says his tactics in Iraq cannot simply be transposed to Afghanistan. Indeed, there are big differences: Iraq is far richer, has a greater density of both American and local forces, its command is more unified, and insurgents enjoy nothing like the cross-border safe havens that the Taliban has in Pakistan's tribal belt.

The scale of any surge in Afghanistan will depend on the speed of withdrawal from Iraq. A brigade originally destined for Iraq early next year will be diverted to Afghanistan. But commanders in Afghanistan have asked for three more brigades on top of that. Having built his reputation in Iraq, General Petraeus will resist a big withdrawal from the country that risks endangering his hard-won achievements. The progress in Iraq, he says, is still fragile and reversible; he will probably want to keep a substantial American presence there at least until late 2010.

In Afghanistan, for now, the Americans are trying to make better use of the troops they have. General David McKiernan, the NATO commander, is in the process of being "double-hatted" as commander of America's separate and more muscular "Operation Enduring Freedom". He will also oversee the training of Afghan forces. This should ensure greater unity of command, though some American special forces, whose actions have at times caused controversy over the death of civilians, will continue to operate separately.

NATO is still plagued by the reluctance of many allies to join the fight and the inability of others to bring more resources. The Dutch and Canadians are expected to stop fighting in the next two years. America has belatedly decided to support the expansion of the Afghan army from 80,000 to 130,000 (still far smaller than Iraq's). Allies that do not supply troops or equipment will be asked for money, trainers and advisers for the Afghan army.

In Iraq, the surge's success was not just due to extra forces. Political changes were crucial, especially the decision by Sunni tribes to switch sides and the ceasefire declared by the biggest Shia militia, the Mahdi

Army. For General Petraeus, this virtuous circle was not a matter of luck but sustained by a transformation in military doctrine that he developed when he ran the army's think-tank at Fort Leavenworth, published in a new counter-insurgency manual in December 2006 and implemented when he took command in Iraq soon after. Soldiers were told their priority was not just to find and kill terrorists but to protect and win over the civilians.

General Petraeus's thinking on counter-insurgency is distilled in 25 pithy maxims, the latest version of which was issued in July. It tells subordinates that "the Iraqi people are the decisive terrain" and that soldiers must live among them and patrol on foot: "You can't commute to this fight." Force alone cannot succeed: "We cannot kill our way out of this endeavour." Instead, insurgents must gradually be crushed from all directions—military, intelligence, politics, development, the media and much more. He calls this the Anaconda Strategy. Quoting Seneca the Younger, he says, "Luck is what happens when preparation meets opportunity."

Much of this thinking has been tried by American forces in Afghanistan, but a shortage of resources, poor co-ordination and unrest in Pakistan have helped send Afghanistan on a downward spiral. Noting the recent fighting by Pakistan's army in the Bajaur tribal region, General Petraeus has expressed his belief—perhaps just a hope—that the country's leaders are ready to deal with violent militants as a mortal threat to Pakistan itself, not just to Afghanistan. He has also let it be known that he sees promise in trying to woo "reconcilable" Afghan tribes, as he did with the "awakening" of Sunni tribes in Iraq.

But success in Afghanistan is uncertain and could take many years. The general has probably yet to work out a strategy for his new area. But his own principles conclude with a warning. "Never forget that what works in an area today may not work there tomorrow, and that what works in one area may not work in another."

South Africa

A new captain's new crew

Oct 2nd 2008 | JOHANNESBURG
From The Economist print edition

A new and probably stopgap president picks some good new ministers

Get article background

A WEEK into the job, Kgalema Motlanthe, South Africa's new president, made a good start. Right after his election by Parliament and after being sworn in, he filled the gaps left by several ministers who resigned after Thabo Mbeki, Mr Motlanthe's predecessor, was ousted by the ruling African National Congress (ANC). His appointments have been welcomed. Now he probably has six months before a general election, expected in April, to heal the rift in the party and to show he can run a government better than Mr Mbeki did.

Markets sighed with relief when Trevor Manuel, the trusty finance minister, was reappointed, though his deputy and heir-apparent, Jabu Moleketi, decided to leave for good. Mr Manuel has been the architect of South Africa's good macroeconomic performance and fiscal discipline. So his reappointment goes some way to assuage fears that the new ANC leadership under Jacob Zuma, expected to become president after the election, may veer left. Mr Zuma has repeatedly tried to reassure business at home and abroad that economic policy would not change fundamentally, but his Communist and trade-union backers have other ideas. Most businessmen were happy to hear a few weeks ago that Tito Mboweni, the central-bank governor, would consider staying after his contract ends next year.

The shifting of Manto Tshabalala-Msimang, Mr Mbeki's health minister, has generally been greeted with glee. She embraced Mr Mbeki's denialist views of HIV/AIDS, to the horror of many abroad and at home, including many in her own department, and did not do much to improve the crumbling public-health system. She has been dispatched to a ministerial portfolio in the presidency. Barbara Hogan, a veteran anti-apartheid campaigner and ruling party MP, takes her place. Ms Hogan is known for speaking out when many in the ANC fell in line with Mr Mbeki over HIV/AIDS. Anti-AIDS campaigners, who fought against the former health minister and have been calling for broader antiretroviral treatment for years, were overjoyed by the news of her appointment, serenading her in front of her Cape Town flat that same evening and offering her champagne. Government relations with AIDS campaigners are looking up. Whether Ms Hogan will be able to improve the creaking and demoralised health system before the next election is another matter.

Charles Nqakula, a former secretary-general of the Communist Party, who as minister of safety and security struggled to bring down crime rates to acceptable levels, has been shifted to defence. His successor, Nathi Mthethwa, has been the ANC's chief whip in Parliament. Other appointments were more obvious: the new ministers for justice, local government, public administration and intelligence all know their fields. The others kept their jobs, as ANC leaders are keen to ensure some continuity after Mr Mbeki's departure.

But Mr Motlanthe will have to make some trickier decisions soon. A Constitutional Court judge is about to retire and must be replaced; a few more are due to go next year, though it is unclear whether this will happen before or after the election. He may have to decide the fate of Vusi Pikoli, the head of the National Prosecuting Authority whom Mr Mbeki suspended last year as Mr Pikoli was about to arrest the chief of police and charge him with corruption. The reserved Mr Motlanthe, an ANC old-timer who is untested in government, will have to show he can steer the ship and deliver more than his predecessor. Otherwise, recent murmurs that a new party may emerge out of disgruntled bits of the old ANC may get louder.

Correction: Elephants in Congo

Oct 2nd 2008
From The Economist print edition

Last week, in our article on poaching elephants in Congo, we referred to that country's “independence in 1964”. It was in 1960. Sorry.

Economist.com WORLD EUROPE

Europe and America

Lessons from a crisis

Oct 2nd 2008 | PARIS
From The Economist print edition

European Schadenfreude over the ills of American capitalism does not signify a dramatic move away from the free market

Illustration by Peter Schrank

Get article background

ONE by one, European leaders have lined up to hail the triumph of welfare over Wall Street. "The idea that markets are always right was a mad idea," declared the French president, Nicolas Sarkozy. America's laissez-faire ideology, as practised during the subprime crisis, "was as simplistic as it was dangerous", chipped in Peer Steinbrück, the German finance minister. He added that America would lose its role as "financial superpower". The Italian finance minister, Giulio Tremonti, claimed vindication for a best-selling book that he wrote earlier this year about the dangers of globalisation.

It would be wrong to exaggerate Europe's sense of self-righteousness over Wall Street's fall. This week governments in Belgium, France, Germany, Ireland and the Netherlands all scrambled to bail out their troubled banks (see article), confirming how exposed Europe's economies are to knock-on effects from America. Even left-wing editorialists in France, quick to sneer at degenerate American capitalism, have tempered their glee. "There would be something comical, even pleasurable, in watching the frenetic agitation of the banking world", wrote Laurent Joffrin, editor of *Libération* newspaper, "if millions of jobs were not at stake, not to mention the economic balance of the planet."

A common thread can nonetheless be detected in European responses to America's troubles. It goes as follows. We always knew that unbridled free markets were a mistake, yet we were derided for saying this; now we are all paying the price for your excesses. In the face of popular consternation at capitalist decadence, the activist state is back in fashion—and we Europeans are taking credit for it.

Yet there are doubts whether this will actually alter any country's policies. There has been much *Schadenfreude* about America in Germany, for instance. The latest issue of *Der Spiegel*, a weekly, shows the Statue of Liberty with her torch out and the strapline, "The price of arrogance: an economic crisis is changing the world". Mr Steinbrück has called for the civilising of financial markets. His boss, Chancellor Angela Merkel, has cited the crisis as proof that she was right at successive international meetings to demand tougher regulation of hedge funds and financial markets—and that the Americans and British were wrong to resist it. Yet she is not going to abandon the free market. The slowing of reform in Germany is mainly caused by gridlock within the grand coalition and the approach of the next federal

election.

A bigger test still is France, home of Colbertism and Gaullism, where *l'Etat* has both a capital letter and a cherished place in the popular imagination—as well as a heavy claim on the taxpayer's purse. Judging by his recent declarations, the centre-right Mr Sarkozy has taken a decidedly leftward turn. In the space of three days, he twice laid into free-market capitalism. "Laissez-faire is finished," he announced in Toulon. "The all-powerful market that is always right is finished."

It is not just rhetoric. With unemployment climbing, Mr Sarkozy has launched a scheme of state subsidies to supplement low pay, paid for by an extra 1.1% tax on capital income that dismayed his own party's deputies. Talk of tax cuts has been shelved. And he has failed to cut public spending to keep his promise of balancing the budget by 2012. Under the 2009 budget unveiled on September 26th, France's budget deficit will be 2.7% of GDP next year, falling to 0.5% in 2012.

Dumbfounded Socialist grandees have been caught off guard. Michel Rocard, a Socialist former prime minister, found himself describing Mr Sarkozy's welfare-to-work scheme as "an intelligent social measure". Laurent Fabius, another Socialist ex-prime minister, said that in Toulon Mr Sarkozy had made a "left-wing speech".

Mr Sarkozy has been labelled *l'Américain*, but Sarkonomics has always defied classification. In industrial policy Mr Sarkozy has a record of backing state bail-outs. As finance minister in 2004 he fought off European Commission disapproval to use state money to rescue Alstom, an engineering firm. In campaign speeches in 2007 he declared that "free trade cannot be a dogma" and called for financial capitalism to be "moralised". One of his first moves in office was to persuade his European Union peers to remove a clause from the now-frozen Lisbon treaty stating that competition was a key EU objective.

Yet Mr Sarkozy has also gone out of his way to impress on the French the need to respond to, not deny, globalisation. He has implored the country that invented the 35-hour week to work more and expect fewer hand-outs from the state. He has exempted overtime work from taxes and social charges. He is tightening welfare rules to cut benefits if the jobless refuse more than two reasonable offers of work. He has strengthened the competition watchdog and made it easier for discount retailers to set up shop. France has moved a long way from the land of sweeping nationalisations under François Mitterrand a quarter-century ago. Mr Sarkozy was elected because French voters knew, however reluctantly, that they had to adapt to global capitalism.

In this respect, a close reading of Mr Sarkozy's Toulon speech is revealing. Alongside his tirades against financial capitalism, he recalled that "capitalism is the system that has enabled the extraordinary development of western civilisation," adding firmly that "anti-capitalism offers no solution to the current crisis." Ms Merkel has, similarly, expressed fears that attempts to discredit free-market capitalism may play into the hands of the left.

Ms Merkel may not wish to attack the free market, but what of Mr Sarkozy's liberalising reforms? He has said that "the crisis calls for an accelerated rhythm of reforms, not a slowdown." On regulation, he wants tighter accounting rules and a rethink of the global financial architecture. On domestic reform, he echoes others' demands for restrictions on executive pay. But he will stick to his efforts to trim bureaucracy, encourage entrepreneurship, discourage welfare dependency, undermine the unions and boost competition.

Most Europeans want to hear reassuring noises about the state taking matters in hand and curbing capitalist excess. But they also know that Europe's traditional high-tax, state-driven economic model had hit the buffers in terms of creating jobs and fostering growth. Some Americans may fret that European-style socialism has arrived on Wall Street. But the mainstream left is unpopular in almost all European countries; the Social Democrats in Germany are scoring record lows in the opinion polls; and the last time the French picked a real Socialist to lead their country was 20 years ago.

The Fifth Republic at 50

De Gaulle revived

Oct 2nd 2008 | PARIS
From The Economist print edition

A new interest in the general who founded the Fifth Republic

NO FIGURE casts such a long shadow over modern France as Charles de Gaulle. Countless avenues, Paris's main airport, a metro station, even an aircraft-carrier are named after him. Television viewers voted him the greatest Frenchman of all time. Next week marks the 50th anniversary of the Fifth Republic that he came out of retirement to found.

This year has seen a surge of interest in the man whom admirers simply call *le général*. In February President Nicolas Sarkozy inaugurated a multimedia museum dedicated to him at Les Invalides in Paris; he will soon open another museum in the general's home village of Colombey-les-Deux-Eglises. The 40th anniversary of the May 1968 student revolt revived soul-searching about de Gaulle: how did the man who restored honour and pride to France after the humiliation of military defeat and collaboration lose legitimacy?

Gaullism is also topical thanks to a revival of statism. De Gaulle presided over part of *les trente glorieuses*: the 30 years of uninterrupted growth during which France's GDP overtook that of Britain. He and his longest-serving prime minister, Georges Pompidou, favoured the use of state planning to develop industry, infrastructure, aerospace and nuclear power. Today, in a timely echo, Mr Sarkozy says that “the state absolutely must intervene, impose rules and invest”. He wants a big investment in energy-efficient infrastructure, including 2,000 kilometres of new high-speed train track, an upgrade of nuclear-power stations and more public transport.

Politicians marshal selective evidence to claim the Gaullist heritage. During the referendum on a European constitution, both yes and no camps argued that de Gaulle would have been on their side. Mr Sarkozy also claims direct descent, even though he has done more than any recent French leader to reconcile France with NATO, whose military command de Gaulle brusquely pulled France out of in 1966. It may be that, at a time of crisis, Mr Sarkozy seeks inspiration from the man who presided over several. As de Gaulle faced the student uprising in 1968, Mr Sarkozy recalled recently, his leadership was on the line. “Once again, General de Gaulle faced up to the storm, and once again the general avoided the worst.”

Austria's election

Unloved coalitions

Oct 2nd 2008 | VIENNA
From The Economist print edition

The far right does well, but the government is likely to exclude it

AFTER a string of electoral defeats and internal divisions, the far right staged a spectacular comeback in the Austrian election on September 28th. Between them, the openly anti-immigration Freedom Party and its offshoot, the Alliance for Austria's Future, led by Jörg Haider, took 29% of the vote, within a whisker of the Social Democratic Party, which remained the biggest party even though its vote fell from 35% to just under 30%. Young voters (whose numbers had risen because the voting age was reduced to 16 before the election) seem to have been as keen on the far right as their older peers, if not more so.

Most analysts agree that voters did not actually move rightwards, but rather wanted to express discontent with the poor performance and squabbling of the outgoing "grand coalition" between the Social Democrats and the conservative People's Party. Alas, they will probably get a government of the same parties, albeit with different faces at the top.

Werner Faymann, who only recently took over the leadership of the Social Democrats from the unpopular chancellor, Alfred Gusenbauer, is adamant that he will not form a coalition with either Mr Haider (whose party took 11% of the vote) or his former protégé turned bitter rival, Heinz-Christian Strache of the Freedom Party (which got 18%). In the campaign he said he would happily link up with the People's Party again, so long as it got rid of its leaders, the party's chairman, Wilhelm Molterer, and its veteran parliamentary faction leader (and former chancellor), Wolfgang Schüssel.

As it happens, the party dumped Mr Molterer when the results came in, for good reason. He had forced a snap election and then run such a poor campaign that the People's Party's share of the vote tumbled from 34% to 26%, a record low. His designated successor is the environment minister, Josef Pröll, widely known to be Mr Faymann's favourite conservative.

Mr Faymann and Mr Pröll may wish to show that the alliance between the country's two big parties, which has ruled Austria for most of the post-war era, can work even with a small majority. Perhaps it can. The failings of the outgoing government arose mainly from Mr Schüssel's refusal to accept his narrow defeat in the 2006 election and his use of Mr Molterer to make life miserable for the Social Democrats.

A continuation of the grand coalition may or may not be good for Austria, but it seems certain to be good for the far right. Mr Strache and Mr Haider, shut out of power, would continue to lambast the "coalition of losers" for carrying on with business as usual. They may also gain from Austrians' rising Euroscepticism (according to the latest Eurobarometer poll, only 36% think that their country's EU membership, which has been a boon to the economy, is a good thing). Even if a grand coalition holds together, it might be pushed by a vocal opposition into populist policies such as tighter immigration control.

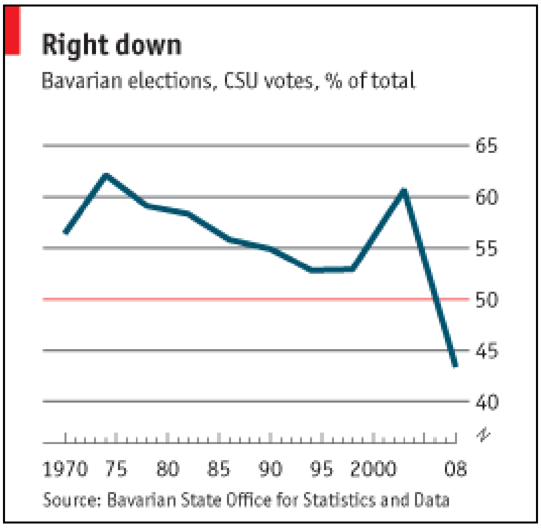
Some Social Democrats have argued for a minority government instead, but neither Mr Faymann nor the federal president, Heinz Fischer, is thought to favour such an experiment. A different way out would be to move away from proportional representation. The two main parties discussed this inconclusively when they had the two-thirds majority needed for constitutional change. With that majority gone, Austria may be stuck with a system that perpetuates unhappy grand coalitions—and feeds far-right parties.

Bavaria's election

Oktoberfuss

Oct 2nd 2008 | MUNICH
From The Economist print edition

A disastrous showing for Bavaria's ruling Christian Social Union



WHEN Günther Beckstein, Bavaria's premier, helped open this year's Oktoberfest—the biggest folk festival in the world, boast Bavarians—on September 20th, he hoped its popularity would rub off on his party, the Christian Social Union (CSU). In vain. In Bavaria's election eight days later the CSU lost its absolute majority for the first time in 46 years. It now needs a coalition partner to stay in power. To Bavarians, the end of one-party rule feels like a revolution. To the German chancellor, Angela Merkel, it is a worrying omen for the federal election due next September. And to all of Germany's big political parties, the results seem proof that they are in deep trouble.

Bavaria has Germany's lowest unemployment, one of its fastest-growing economies and its lowest debt per head. Clinging to Catholic and folk traditions but revelling in progress, Bavarians have fashioned a regional identity stronger than any other in Germany. For decades they looked to the CSU to champion their interests. In other states Ms Merkel's Christian Democratic Union (CDU) speaks for mainstream conservatives; in Bavaria it is the CSU.

But a long period in power breeds arrogance. Edmund Stoiber, who led the CSU to a two-thirds majority in 2003, got bureaucrats to work longer hours and students to cram nine years of education into eight without enough planning. His ousting in 2007 by Mr Beckstein, the state's interior minister, and Erwin Huber, who became party chairman, subtracted charisma without adding competence. The ageing conspirators enraged innkeepers by implementing Germany's toughest smoking ban, and everybody else when the state-owned Bayerische LB said it would lose over €1 billion ($1.4 billion) in subprime punts. "I have no trust in Beckstein and Huber," says Bernhard, a technology consultant sporting Bavarian *Lederhosen*.

On September 30th Mr Huber was forced out as party chairman, to be replaced by Horst Seehofer, the federal agriculture minister. Mr Beckstein quit a day later. Yet even these beheadings do not portend a real revolution. Voters who turned against the CSU turned towards their ideological kin. The Freie Wähler, a haven for CSU rebels, took a tenth of the vote and got into the legislature.

The CSU would have a hard time governing with such a "club of individualists", says Heinrich Oberreuter of the Academy for Political Education in Tutzing. Its likeliest partner is the liberal Free Democratic Party (FDP), which re-entered the legislature after a 14-year absence. Bavaria's pro-business policy will continue, though the FDP is more likely to protect civil liberties than the CSU.

Strikingly, the Social Democratic Party (SPD), the main opposition force in Bavaria but partner of the CDU/CSU in Germany's "grand coalition" government, did not profit from the CSU's woes. Its 18.6% share of the vote was its worst ever. There is no sign that its countrywide erosion has stopped. Besides the FDP and the Freie Wähler, the Greens were the other big winners.

A demoralised CSU will make life harder for the grand coalition. The Bavarians resent Ms Merkel for squelching tax-cut proposals with which they hoped to stave off electoral disaster. When the government's plans clash with the interests of their voters, as they may over reform of inheritance tax, the CSU will oppose them. The grand coalition may also soon lose its majority in the upper-house Bundesrat.

Ms Merkel needs Bavarian votes to win re-election, but she should not despair. The Freie Wähler have no national presence and the FDP is a potential ally, so she could keep many of the votes the CSU lost. As for

the CSU, its “aura of invincibility is gone,” says Mr Oberreuter. Newcomers drawn to Bavaria by its economic success are more likely to programme laptops than wear leather shorts.

Belarus's election

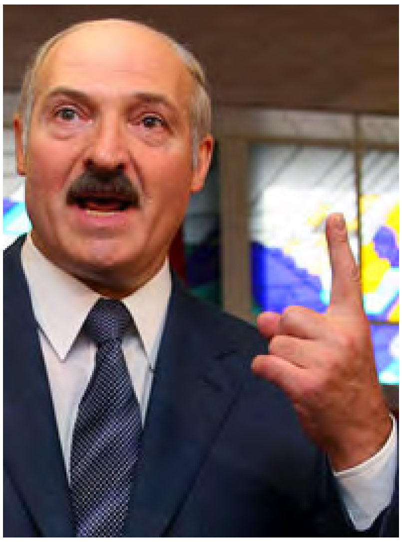
Dictator at bay

Oct 2nd 2008 | MINSK
From The Economist print edition

A deeply flawed election, but the West is softening its stance towards Belarus

Get article background

AFP



Lukashenka lifts a finger to the West

IN A country the Americans have dubbed the last dictatorship in Europe, it is not surprising when an election is criticised by international observers. In Belarus's vote on September 28th, candidates loyal to the president, Alyaksandr Lukashenka, took all 110 seats. European monitors talked of only "minor improvements" on previous flawed votes, called the election campaign "barely visible" and found serious fault with the count.

This poses a dilemma for the West. America and the European Union must decide soon whether Belarus's minimal progress in a democratic direction is enough for them to curtail their sanctions on the country. Mr Lukashenka, a former collective-farm boss who has been in power for the past 14 years, says he is expecting the sanctions to go. Otherwise he threatens to stop talking to the West altogether. Russia's war with Georgia in August has made Mr Lukashenka, for all his flaws, a man worth courting.

Belarus has survived as an independent entity since the break-up of the Soviet Union thanks to cheap Russian natural gas. As the Kremlin prepares to impose a sharp rise in the price of gas, some European diplomats believe it is a good time to woo this on-off Russian ally, especially since Mr Lukashenka has made the first moves. To curry favour with the West, he released political prisoners, allowed some opposition campaigning and invited foreigners to watch. He hired a British public-relations firm, Bell Pottinger. And he resisted Russian pressure to recognise the Georgian enclaves of South Ossetia and Abkhazia.

Belarusian officials say the loosening of the reins reflect economics, not a sudden realisation that democracy is a good thing. The economy is feeling the strain. One of Mr Lukashenka's first post-election decisions was to pass an energy-saving decree. In Minsk public buildings fitted with movement sensors are shrouded in darkness after sunset. The roads are uncongested; the airport is more a museum than a transport hub.

Mr Lukashenka seems in a mood to bargain, an offer the opposition think should be ignored. "If Europe makes one step forward in political and economic co-operation, we will make three steps," he vowed after the poll, adding smoothly that "an election cannot be ideal."

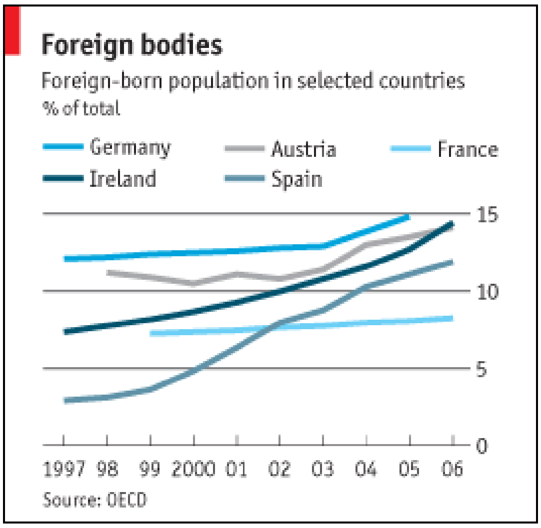
Immigration and the European Union

Letting some of them in

Oct 2nd 2008 | BRUSSELS
From The Economist print edition

The European Union's immigration pact offers a promise of tighter controls but may have little real effect

IMMIGRATION has Europe in a pickle. With ageing populations and low birth rates, the European Union needs more people. But EU countries are already taking in plenty of foreigners (see chart), and many struggle to integrate. Popular resentment of immigration is increasing, and may rise further as economies slow and unemployment climbs. Meanwhile hundreds of illegal migrants risk life and limb on leaky boats to get to Europe every week.



Source: OECD

France's Nicolas Sarkozy has made immigration a centrepiece of the French EU presidency. As interior minister he took a hard line on immigration, which helped win him votes in the 2007 presidential election. The new "pact" on immigration and asylum, due to be adopted by an EU summit in mid-October, is his idea.

Its main justification is that, given free movement of people around the EU, different national policies no longer make sense, especially in the passport-free Schengen area. The pact suggests common approaches: immigration should be more selective (a "blue card" modelled on America's green card will try to lure highly skilled migrants); and illegal immigration should be tightly controlled, with more returns and beefed-up border controls.

The main new idea is to scrap mass amnesties for illegal immigrants, such as Spain's in 2005, on the ground that these simply lure in more people. Denmark won support for tough language that seeks to stop laws on freedom of movement from encouraging illegal immigration. To Malta's relief, countries receiving large numbers of asylum-seekers will be able to share the burden (and cost) with others.

Asylum and immigration have fallen within the EU's competence since the Amsterdam treaty in 1997. Five-year work plans were agreed in Tampere in 1999 and The Hague in 2004; a third is due to be adopted under the Swedish EU presidency next year. Is the new pact a sign of French dissatisfaction with this process? Eurocrats hope it will create new impetus. But it also puts more stress on direct co-operation between governments, cutting out Brussels.

Will the pact make much practical difference? Bureaucrats are poor at guessing future labour-market needs. Europe is in a global competition to attract talent, but most EU members are disadvantaged by language: English is the new lingua franca. The blue card is less generous than others, notes a forthcoming report from Bruegel, a Brussels-based think-tank. It covers a shorter period than the green card, for instance.

The pact invokes the concept of circular migration to argue that immigration can benefit both sending and receiving countries. Unlike previous guest-worker schemes, the pact suggests, improved technology will mean that more people really will go home. But some will not. And an OECD report suggests it can be inefficient for employers to retrain staff rather than retain experienced workers for longer.

The pact's proposed sanctions on employers of illegal immigrants are also controversial. Businessmen complain that the red tape for employers who want to hire third-country nationals is already onerous, and that their role is not to act as government snoopers for illegal migrants.

Enforcing departures, the ultimate sanction, remains slow and costly. Estimates of illegal immigrants in the EU range from 4m to 8m, with half a million more arriving every year. Yet even hawkish France sent

back only 25,000 in 2007. A new directive on returns, criticised by some developing-country governments, may ensure that more are sent back.

So far this year, patrols have stopped 20,000 people trying to cross the Mediterranean. But they may just displace migrants to other, easier routes. The EU's southern and eastern borders remain porous. And suggestions that more avenues for legal migration might reduce demand for the illegal variety seem wrong. Rapid population growth and high unemployment in Europe's near-abroad, plus a huge income gap, all argue otherwise.

If the goal were to strengthen links between immigration and development, the answer would be to make a case for more open borders. But that goes far beyond what politicians think voters will stomach. For now, the illusion of tighter immigration controls confers domestic political benefits, even as its failings are ignored.

Charlemagne

A changed climate

Oct 2nd 2008
From The Economist print edition

The European Union is struggling to deliver on its promises to cut carbon emissions

Illustration by Peter Schrank

JUST 18 months ago the European Union promised to save the world from climate change. A final plan to deliver on those promises must be finished soon. But it is in deep trouble.

The conclusions of the March 2007 summit proclaiming the EU's "leading role" on climate change make for wistful reading today. They begin "Europe is currently enjoying an economic upswing," and add that growth forecasts are "positive". Back in that long-lost golden age, the EU's leaders were in heroic mood. They offered binding promises known as the 20/20/20 pledges. By the year 2020, they would cut Europe's carbon emissions by at least a fifth over 1990 levels; derive 20% of all energy from renewable sources; and make energy-efficiency savings of 20%.

The heroic mood is gone now. In March 2007 Angela Merkel, the German chancellor and chairman of the summit, was a green champion. Today she sounds like a lobbyist for German business, listing the industries that must be shielded from the full costs of her package. In truth, almost every country has found reasons why the climate-change promises may be impossible to meet in their current form. Britain is gloomy about its renewable-energy targets. Ireland says its farmers must be protected (grass-fed Irish cows emit a lot of methane).

Dig into most "impossible" problems on the table, and they come down to money. In the EU, rows about money are usually settled, albeit acrimoniously. But another problem is harder to fix. Countries that use a lot of coal, such as Poland, fear that the climate-change package will force them to abandon it. The quick and easy alternative is natural gas, but the fear is that this means Russian gas. Russia made its neighbours nervous even 18 months ago; after its war on Georgia it frightens them even more.

Poland gets over 90% of its electricity from coal. The giant Siekierki power station in Warsaw provides electricity and heating to two-thirds of the Polish capital each winter. A mountain of coal next to its turbine hall holds 180,000 tonnes, enough for 18 days' winter production. Ignore climate change, and it is an oddly comforting place. Almost all the coal is Polish, and more arrives on trains from Silesia every day. On an autumn afternoon, the only smells are of fallen leaves and the sweet tang of fresh coal. The only noise comes from a bulldozer smoothing the coal-mound and the cawing of rooks. Its three chimneys run clear: you cannot see the carbon dioxide pouring into the sky.

The heart of the EU's climate-change package is an emissions-trading scheme (ETS) that will make factories and power plants like Siekierki pay for emitting carbon. The higher the price of carbon in the

ETS, the stronger the signal to switch away from coal. Polish ministers have been galvanised by recent reports that the carbon price will be much higher than European Commission estimates. A February 2008 paper from UBS, a Swiss bank, caused alarm by predicting that 43% of Europe's coal-fired power generation will switch to gas because of EU emissions targets.

In the long term, Poland is pinning its faith on clean-coal technologies, including carbon capture and storage. But that will take years. (Polish officials say nuclear power is another option, but that would take years too.) What worries them is the medium term, when they want to keep burning coal. “Coal is our energy security,” says Mikolaj Dowgielewicz, Poland's Europe minister. On September 26th ministers from Bulgaria, Hungary, Poland, Romania and Slovakia signed a joint declaration expressing concern that the climate-change plan would “significantly increase” the dependence of some countries on imported gas. With the package “in its current form”, there is no chance of an agreement among the 27 EU countries, concludes Mr Dowgielewicz.

The irony is that energy security was key in persuading the east Europeans to sign up to the climate-change package in March 2007. Their leaders were assured that a shift to renewable energy would help them avoid excessive dependence on imports. The March 2007 conclusions pledged more EU “solidarity” in the event of a supply crisis (eg, Russia turning the taps off). There were pledges to diversify supplies, and support for named projects like the Nabucco pipeline that would bring Caspian gas to central Europe, bypassing Russia.

Accommodating a Russian bear

But most of these promises were hollow. EU countries continue to sign deals with Russia that undermine Nabucco. Germany still defends the Nord Stream gas pipeline, a joint project with Russia's Gazprom. The war in Georgia showed how the EU maintains unity when dealing with Russia: by accommodation. And Russia's leaders have been busy all around the EU's periphery, defending Russian transit routes, and seeking to invest in new pipelines that will bring gas to Europe (including one from Nigeria), but under their influence or control.

Earlier this year, Russia said it would build a nuclear complex in Kaliningrad, an exclave between Poland and Lithuania. Too large for Kaliningrad's domestic needs, it has export potential, Russian nuclear chiefs said. That poses a dilemma for the neighbours. Once it is open, some time after 2015, it will offer zero-carbon electricity—but also more dependence on Russian energy.

Poland wants fiddly changes that might make it easier to keep burning coal and not be bankrupted by the ETS. But nobody can blame the ETS for pushing generators away from coal. It is designed to make high-carbon fuels unattractive, after all.

There is a bigger solution available. The EU could deliver on some of the promises of March 2007 about energy security. That means fewer cosy bilateral deals with Russia, planning more terminals for liquefied natural gas imports, supporting pipeline projects that bypass Russia, linking up power grids and pressing ahead with energy liberalisation. The east Europeans will not accept a climate-change package that does not offer them greater energy security—and who can blame them?

Mortgage malaise

Closer and closer to home

Oct 2nd 2008
From The Economist print edition

As fear stalks the markets, the government may have to do more to steady nerves

eyevine

LITTLE more than a year after the run on Northern Rock, which was halted only by an unprecedented Treasury guarantee to the mortgage bank's depositors, the government had to contemplate a similar drastic step this week to prop up Britain's banking system. The renewed crisis shows how widely mistrust in banks has spread over the past 12 months. And it reflects growing anxiety about the exposure of British mortgage lenders to possible crippling losses on risky loans as the economy falters, the property market falls and borrowers get into trouble.

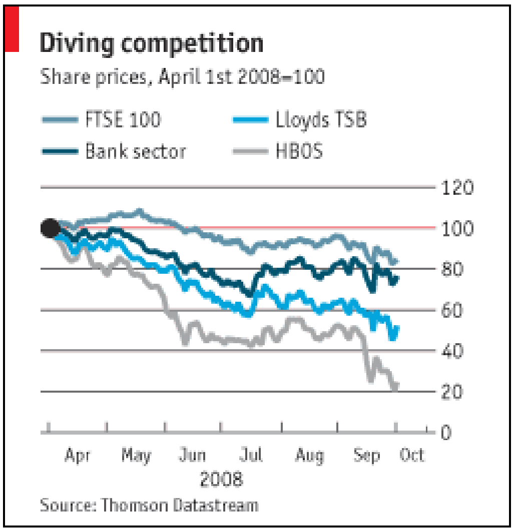
The sense of foreboding intensified during the week despite the government's firm action over the weekend to deal with Bradford & Bingley, another troubled mortgage lender. In contrast with the dithering over Northern Rock, ministers acted decisively to forestall another retail run and to ensure that deposits were placed in secure hands (see article).

The hope was that the government's intervention would do much to allay worries. Its nationalisation of Bradford & Bingley's assets, following that of Northern Rock, means that 11% of mortgage loans outstanding at the end of 2007 are now in state hands. And the steps taken by the government on September 18th to smooth Lloyds TSB's takeover of stumbling HBOS should in theory have brought Britain's biggest mortgage lender, with a fifth of all loans, into safe custody, creating a group holding 28% of all mortgages by value.

Yet anxiety mounted and shares plummeted. As dealers and investors peered deeper into the entrails of the banking industry following the sudden demise of Bradford & Bingley, the crucial tie-up between Lloyds TSB and HBOS started to look increasingly shaky (see chart).

Under the terms of the takeover, Lloyds TSB is offering 83% of a share for each HBOS share. Right after the bid, HBOS shares moved close to that implied value. But as credit worries intensified, the two parted company, most notably on September 30th, when HBOS fell by 13.8% whereas Lloyds TSB rose by 4.3%.

That left HBOS shares 35% below the implied value of the bid—a discount suggesting that the stockmarket no longer believed the takeover would go through. Although the discount narrowed on October 1st, as HBOS shares rallied more than those of Lloyds TSB, it still remained worryingly high at 29%.



The doubts about the deal reflect a re-evaluation of the risks to banks from Britain's property bust. House prices have fallen by 12.4% in the year to September, according to Nationwide Building Society. A decline of 25% from peak to trough, which now seems likely, would push between 2m and 2.5m borrowers into negative equity (with a house worth less than the loan on it), according to Michael Saunders, an economist at Citigroup, a bank.

Estimates of Britain's exposure to high-risk mortgage loans vary. The two main categories are subprime loans made to people with poor credit histories and "self-cert" loans made on the basis of unverified assertions of income. Together these make up about a tenth of the value of outstanding mortgages, estimates David Miles, an economist at Morgan Stanley, a bank. On top of that there are worries about the quality of assets in the buy-to-let sector, where banks have lent to private landlords. Such loans comprise a further tenth of mortgage debt.

The collapse of Bradford & Bingley, which specialised in buy-to-let lending, has rekindled worries about the quality of these assets. On the face of it, the concern looks misplaced. At the end of June, only 1.1% of buy-to-let loans were three months or more in arrears, whereas 1.3% of all mortgages were. But the deterioration since June 2007 was greater; such arrears accounted then for only 0.6% of buy-to-let loans against 1% for the overall market. Over the same period, the share of Bradford & Bingley's buy-to-let loans in similar arrears worsened from 0.9% to 1.9%.

One reason for the greater vulnerability of such lending is that the buy-to-let market expanded sharply in the final years of the housing boom—from 6.5% of mortgage debt at the end of June 2005 to 10.9% three years later. Purchasers have had less time to benefit from the long house-price boom: virtually all the gains in house prices between mid-2005 and last autumn have now been wiped out by the fall in prices.

Worries about exposure to bad debts are adding to the funding difficulties banks have faced for some time. Most rely heavily on wholesale funding from the capital markets rather than on more reliable retail deposits. Mortgage lenders have been hit by the effective closure of the mortgage-securitisation market, which by 2006 was providing two-thirds of net new lending.

The Bank of England has helped banks through its "special liquidity scheme", which is enabling them to swap over £100 billion ($177 billion), or about a tenth, of their mortgage assets into readily tradable Treasury bills. The central bank also injected an unprecedented £40 billion of funds over three months on September 29th. Yet a crucial barometer of stress—the gap between the interbank three-month lending rate and expected average base rate over the same period—rose to new highs as banks clung on to what cash they had.

With nerves so frayed, further government action looks imperative. Gordon Brown said this week that he would do whatever it took to ensure the safety of deposits. The prime minister has indicated that the £35,000 limit on protection for deposits at any one banking group will soon be raised to £50,000. That still falls short of the blanket guarantee the Irish government extended on September 30th—and America may raise its limit to $250,000.

The Bank of England could provide some succour on October 9th. Although inflation is still way above target, the central bank's rate-setters may well argue that the events of the past two weeks have intensified the likely downturn, making the case for an early rate cut. As the unfolding credit crisis has shown, extraordinary times justify extraordinary measures.

Bradford & Bingley

Death of a one-trick pony

Oct 2nd 2008
From The Economist print edition

The regulators get it right

Reuters

Too many hats, not enough heads

UNLIKE the botched nationalisation in February of Northern Rock, a troubled mortgage lender, or the forced monster merger—which could still come unstuck—of Lloyds TSB and HBOS announced on September 18th, the neat filleting of Bradford & Bingley (B&B) ten days later seemed to show Britain's financial regulators at last on the front foot. B&B is the last of those former building societies that demutualised after a 1986 law made it possible, and became publicly listed banks. Its assets have been nationalised and its retail deposits sold to Spain's Banco Santander.

The Treasury acted under a bank-rescue law passed after Northern Rock's nationalisation, moving as soon as the Financial Services Authority declared B&B unlikely to meet its obligations. Attempts to sell the bank in its entirety to the usual suspects had failed. But Banco Santander agreed to pay £612m ($1.1 billion) for £20 billion in retail deposits and 197 branches. This will add 2.7m customers to those of Abbey, Santander's subsidiary since 2004, and Alliance & Leicester, another once-mutual lender that Santander acquired in July. The combined bank will have about 10% of all retail deposits, less than Lloyds TSB/HBOS and RBS. Unlike previous rescues, this one puts depositors in the hands of a foreign bank with diverse businesses in Britain, Iberia and Latin America.

B&B's shareholders, including those who reluctantly stumped up £400m in July for a rights issue, are likely to emerge with nothing, as are holders of subordinated debt. But as with Northern Rock, all deposits have been guaranteed—not just the £35,000 that is automatically covered by the Financial Services Compensation Scheme—to forestall a run on other banks.

The risks hidden in B&B's deteriorating £40 billion mortgage book will be borne mainly by British banks, through future contributions to the compensation scheme. Only if that £14 billion pot runs dry as B&B's mortgage book is run down will the taxpayer be called upon. This gives other banks and building societies an interest in maximising the proceeds from B&B's mortgage book.

It also means they share the consequences of allowing one of their number to exploit the fast-growing but risky market for buy-to-let mortgages, which account for 60% of B&B's portfolio. These were supposed to be doubly secured by two income streams: that of the owner and that of the tenant. They are turning out to be vulnerable: because of lax underwriting the rental income alone often fails to cover the mortgage payments. And buy-to-let mortgages were—apart from a sideline in self-certified mortgages, a licence for borrowers to lie about their income—B&B's only trick.

Its depositors are better off with Banco Santander. But relegating shareholders to the bottom of the heap will make investors even less keen on providing money to the undercapitalised banking sector. After this, the government may find itself the only source.

The Conservative Party

A poisoned chalice?

Oct 2nd 2008 | BIRMINGHAM
From The Economist print edition

A return to power still looks likely for the Tories, if not entirely attractive

Reuters

Cameron: a man with a plan

David Cameron

AT MOST of their annual conferences over the past decade, senior Conservatives have had to feign jollity in the face of dismal electoral prospects. So they must have been discombobulated by instructions to do just the opposite at this year's gathering, which took place in Birmingham from September 28th. Despite their comfortable lead in the polls, they pulled it off. Champagne receptions and celebratory speeches were ditched to avoid seeming smug at a time of economic crisis. The Tory leader, David Cameron, even gave his set-piece speech on October 1st from a lectern, calculating that his usual gambit of roaming the stage without notes would be inappropriately showy.

After avoiding triumphalism, the Tories' main objective was to show a sure touch on the economy, and here their performance was mixed. An offer to co-operate with the government provided a welcome contrast to the partisan rancour in Washington. George Osborne, the shadow chancellor, briefly returned to London during the conference for a summit with Alistair Darling, his opposite number, and Vince Cable, the Liberal Democrats' Treasury spokesman. After a Labour Party conference that sometimes sounded a little too pleased by capitalism's travails, the Tories stood up for the market without exonerating bankers from the charge of irresponsibility. And Mr Osborne's long-standing refusal to promise an overall cut in taxes looks vindicated, in the face of a burgeoning fiscal deficit.

But the Tories fell short of offering a clear way out of the economic crisis, or at least a clearer one than the government. They want to hasten legislation governing the rescue of failing banks, increase protection for depositors and revisit rules on the valuation of banking assets that may be exacerbating the crisis: all familiar policies. A new independent "office for budget responsibility" (with limited powers) would ride herd on the sort of chicanery they accuse Mr Brown and the Treasury of, such as fiddling fiscal rules. Mr Osborne's main giveaway was a qualified pledge to freeze council tax for two years—a nice enough break for hard-pressed households but hardly a magisterial take on the credit crunch. And Mr Cameron's speech ranged across domestic and foreign issues—proof that the Tories can see beyond the current economic crisis, perhaps, but also a sign that they lack answers for it.

Whatever their missed opportunities, the Conservatives can console themselves that the economic upheaval of recent weeks may have changed the game, but not its probable winner. Gordon Brown bought time for his faltering premiership with a strong showing at Labour's own party conference, but the Tories are still favoured to win the next election, which must be held by June 2010.

What the crisis has done is render that victory a less attractive prospect than it was, promising an inheritance consisting of a hefty fiscal deficit and growth that is slow if not negative. There is a chance that the Tories' first budget in government would have to emulate Margaret Thatcher's infamous one of 1981, which raised taxes during a recession. Some of the Tories' most prominent policies—paying private firms to get the unemployed into work, for instance—might have to be revised or delayed. And public sector reform costs political capital as well as money. Perhaps the Tories' most promising policy is the expansion of choice and competition in education, but a government that has lost popularity by taking tough economic decisions may be too weak to face down inevitable opposition from teaching unions.

Economic gloom also means that Tories longing for the kind of victory Labour enjoyed in 1997 will at best get only half their wish: a landslide may be possible (though it looks less likely than it did) but there will

be little of the euphoria surrounding Tony Blair’s triumph. A closer comparison, says one Tory insider, is with 2001, when an electorate unimpressed with the government but contemptuous of the alternatives reluctantly gave Labour a handsome win. The traditional honeymoon would be vanishingly brief. If the Tories did a good job of looking grave in Birmingham, it’s probably because they were.

Political parties

Hero worship

Oct 2nd 2008 | BIRMINGHAM
From The Economist print edition

How parties see themselves

THE hero a party chooses says something about its current view of the world—but what, exactly? Margaret Thatcher walked it as the Conservative delegates' Greatest Tory at a fringe event on September 29th organised by the *Guardian*. But Winston Churchill, joint saviour of the free world only about 60 years ago, edged out the Whig philosopher Edmund Burke by just one vote. Benjamin Disraeli, the deft shaper of modern Conservatism, finished fourth.

A week earlier Labour chose its favourite son. James Keir Hardie, the Scottish miner who helped found the Labour Party and first led it, beat Clement Attlee (whose legacy was the welfare state) and Aneurin Bevan (ditto the NHS), to say nothing of a powerful minister, Barbara Castle. Last year the Liberal Democrats, who started the craze for identifying party greats, elected the liberal philosopher John Stuart Mill over the reforming prime minister David Lloyd George.

Straw polls at best, these votes were no doubt heavily influenced by attendance on the day and the oratorical skills of each candidate's proposer. They bear examination nonetheless. It is tempting to read in the victory of the Utopian socialist Keir Hardie a lurch to the left by a party behind in the polls and nostalgic for the certainties of more heroic times. For her part, Lady Thatcher was redder in capitalist tooth and claw than today's compassionate Conservative leadership often seems quite at ease with. Both were conviction politicians *par excellence*—though their convictions could not have been more different. On this analysis, political parties, for years clustered claustrophobically in the centre ground, are about to diverge and get interesting again.

Or perhaps not. Vernon Bogdanor, professor of government at Oxford University, suggests that neither Keir Hardie's dream of transforming society nor Lady Thatcher's determination to deregulate and the devil take the hindmost has much to offer today. Social democracy has had to engage with market economics; Lady Thatcher's lack of concern for society is irrelevant at a time when broken markets threaten innocent bystanders. It is Mill's message of freedom and tolerance that has worn best.

For the Conservative leader, David Cameron, a final observation may prove sobering. Though the Tories have long been seen as the party of "the establishment", their four finalists were all outsiders, as David Marquand, an historian and a former Labour MP, points out. Burke was Irish, born of a Catholic mother, at a time when Ireland was essentially a colony held down by force. Disraeli's ancestry was Jewish, not exactly a ticket to higher office in his day. Churchill ratted from the Conservative Party in 1904 (to the Liberals), then formally re-ratted in 1925. And Lady Thatcher, the first woman to lead the party, was initially considered a bizarre choice even by members of her own shadow cabinet.

Mr Cameron is himself a quintessential insider. His choice for Greatest Tory? Robert Peel, says the *Guardian*'s Michael White, who ran the event. The 19th-century prime minister and repealer of the protectionist Corn Laws split his party and left it in the wilderness for 28 years—but he did manage to modernise it.

Education policy

Swedish lessons

Oct 2nd 2008
From The Economist print edition

The Tories assume the mantle of social democracy

THE word “Sweden” was much in evidence when the shadow schools secretary, Michael Gove, addressed the Tory party conference on September 30th. That country’s free-market education reforms, he said, would immediately be copied in England were his party to gain power. In the 14 years since Sweden’s government started paying private schools to educate children at the taxpayer’s expense, 900 new schools, teaching 15% of all children, have opened. Mr Gove conjured up visions of innovative entrants “selling themselves to parents” and driving up standards to previously unimagined heights.

The Swedish precedent is a gift to the Tories. They have been keen for some time to open up the supply side in schooling: their 2005 manifesto promised a “voucher” equal to the cost of a state education to any private school willing to charge parents no more than that. But the policy seemed other-worldly, as the likely value of the voucher was less than the fees at any existing private school. Now that it has been reframed as a mechanism for creating new schools, the fact that it has worked elsewhere makes it seem less implausible. And the example of social-democratic Sweden moves it out of the realm of swivel-eyed free-marketry and into that of cuddly, compassionate New Conservatism.

In most respects, the schools would run as in Sweden: no charges, no entrance exams, no religious criteria and admission in order of application. But there would be one crucial difference: a ban on profit-making. “Foundations, charities, co-operatives and others” have opened schools in Sweden, Mr Gove told his party, glossing over the fact that most of Sweden’s independent schools are run by private firms.

“The experience of Sweden is that profit drives expansion, not entry,” insists Mr Gove. But Carl-Gustaf Stawstrom, the managing director of Sweden’s Independent Schools Association, thinks the restrictions could strangle a nascent market. His country’s pioneers were indeed mostly frustrated parents or educational innovators rather than strictly commercial operations. And if shareholder dividends were ever banned in Sweden, he thinks most firms already running schools would simply restructure as providers of educational services (profit-making) to schools (non-profit-making). But it is questionable, he says, whether they would ever have entered a market with those rules.

Mr Gove says his position on profits is driven by a desire not to fracture a growing but fragile consensus within and without his party, and could be rethought if necessary. He is also keenly aware of the need to reform England’s onerous planning regulations as well as rules regarding school premises (many Swedish independent schools are plonked into converted office blocks). And it is the possibility of new schools, as much as their actual numbers, that raises standards. Much of the improvement in Sweden has stemmed from existing schools raising their game to fend off competition.

While teething problems with the Swedish import are being resolved, Mr Gove’s other big idea could already be transforming English education. That is to allow all successful state schools to become academies. These are entirely funded by taxpayers but have extra freedoms over matters such as curriculum and teachers’ pay. At the moment each replaces a failing school and is authorised individually by Lord Adonis, the minister who thought up academies. That makes them rare (fewer than a hundred exist so far) and expensive (around £25m each in capital costs). Allowing all successful schools to convert would spread the benefits of self-management farther, and much faster.

At a meeting earlier this year, Lord Adonis listened as Mr Gove lauded the Swedish system. When it was his turn to speak, he told the audience that academies were his version of the “Swedish model”. In the run-up to the Tory conference, Mr Gove let it be known that Lord Adonis would have a home in any future Tory administration, should he want it. One way or another, more English children may soon be taking lessons from our friends in the north.

High-speed rail

Fast trains to take the strain

Oct 2nd 2008
From The Economist print edition

The Tories come out for superfast trains and against expanding Heathrow

Get article background

“THERE is no more money,” intoned George Osborne, the Conservative shadow chancellor, to the ranks of the faithful at the Conservative Party conference on September 29th, castigating the government for profligacy during the good times. But Mr Osborne’s fit of the dismals did not stop Theresa Villiers, the party’s transport secretary, from promising on the same day that a Tory government would scrap proposals for a third runway at London’s Heathrow airport and spend £15.6 billion to build a French-style high-speed rail line connecting London and Leeds via Birmingham and Manchester by 2027. She also foresees a spur linking Britain’s only existing high-speed line (from the Channel Tunnel to London’s St Pancras station) to Heathrow airport.

Ms Villiers promised plenty of benefits. A high-speed line would cut journey times from London to Leeds by 28 minutes, and to Manchester by 45 minutes. That would ease the strain on existing lines, making more room for freight trains and commuter services. Displacing domestic flights and enabling travellers from Paris and Brussels to reach the north of England by train would mean 66,000 fewer flights a year from Heathrow, removing much of the justification for a third runway at that crowded airport. And electrically powered trains would emit less nasty carbon than fossil-fuelled aircraft.

But whereas green groups and rail lobbyists queued up to praise the idea, more traditional Tory supporters were aghast. Willie Walsh, boss of British Airways, said the idea that high-speed trains could replace a third runway at Heathrow “beggars belief”. The Confederation of British Industry was more diplomatic, saying that while it supported a snazzy new railway line, a new runway for Heathrow was still necessary. Others pointed to the contrast between Ms Villiers’s enthusiasm for trains and a suggestion made recently by Boris Johnson, the Conservative mayor of London, that a new airport should be built in the Thames estuary. Scottish politicians accused the Tories of ignoring their constituents, unmollified by vague promises that the line would eventually be extended north of the border.

With the remains of Britain’s financial system still smouldering ominously, complaints from London businessmen may not garner much public sympathy. But the merits of the Tories’ scheme are murky. Ms Villiers’s proposal spans a modest four pages. Diverting money from the existing rail budget (an increasing proportion of which is intended to come from farepayers) will mean less for already crowded commuter routes into big cities—exactly those routes identified in a big government study conducted by Sir Rod Eddington, a former head of British Airways, as the most important places for new investment. Comparisons with other countries (such as France and Japan, two high-speed rail pioneers) are fraught with difficulty, partly because funding tends to be opaque and partly because other countries are often less concerned that their investments be economically self-supporting than the British. On the Tories’ own figures, building a high-speed line would eat up a quarter of the annual rail budget, whereas a conventional one would require only 17%.

There is also the question of how quickly such a link could be built. High-speed rail enthusiasts can point to the success of the high-speed line to the Channel Tunnel, which was finished on time in 2007. But doubters have a ready counter-example in Crossrail, an ambitious £16 billion plan for a cross-London rail line that has been mired in delays and revisions for decades—and whose future, in the midst of the cash crisis referred to by Mr Osborne, is once again looking dicey.

Supermarket finance

A mortgage from Tesco?

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A retailer branches out

MORTGAGE banks may be falling like ninepins, but that does not matter to Tesco, Britain's leading supermarket chain. "Mortgages are looking quite attractive as a line of business," said an official this week, as the firm reported buoyant half-year profits to August 23rd. Later this month Tesco expects to take full ownership of Tesco Personal Finance (TPF), its 11-year-old joint venture with RBS, a retail bank, and has big plans for it. TPF now has around 5.6m customer accounts with deposits, savings, loans and credit cards. It made a relatively modest £71m profit over the past six months, but wants to increase that, along with profits from other services including telecommunications, to £1 billion a year.

Tesco has the freedom to expand into banking, touting its well-known brand, because its main business is thriving, even in tough markets. Global retail sales grew by 14% and profits by 11% compared with the same period last year. It has seen particularly strong growth in Malaysia and Poland, and rapid expansion (but a small loss) in China. Even in its embattled British home market (which accounts for over 70% of its business), turnover in its seasoned stores rose by 3.7%. Its upmarket rival Marks & Spencer, by contrast, has seen a 6.1% drop in sales over the past quarter.

Analysts reckon that Tesco too has lost some customers to stores that discount their goods heavily, but it still accounts for more than 30% of all supermarket sales. Its smaller "Express" shops—designed to compete with little convenience stores—have invaded the high street, with profitable results. As prices rise and disposable incomes are squeezed, shoppers are foregoing car journeys to out-of-town supermarkets and expensive nights out, staying at home with a couple of DVDs and food and wine from their local grocer.

That is partly the fault of higher petrol prices but may also—perversely—reflect the efforts of local planning bodies to protect independent stores in town centres by blocking new supermarket developments outside them. Raffaella Sadun, of the London School of Economics, has found that supermarket chains, denied an out-of-town site, are more likely to set up in town centres themselves, bringing the battle straight to the high street. Some corner stores benefit from having a mini supermarket next door because it attracts more shoppers to the area; others decide to specialise; and the less fortunate are sometimes driven to bankruptcy. The message of Ms Sadun's study seems to be that denying planning permission to supermarket "boxes" does not preserve high streets from change—rather the reverse.

One might expect the Competition Commission to have something to say about this, and it does. The watchdogs are working on ways to reduce the retail dominance of supermarkets, to which customers normally flock however much they lament the threat to independents. More concerned with securing the benefits of competition for consumers than with ruling on who should operate where, they proposed in April applying a "competition test" to guide decisions made by local planning authorities. Most supermarkets have protested, and Tesco will contest the whole idea of "adding another layer of bureaucracy" before a tribunal in November. The commission's other proposal—that supermarkets appoint and pay for an ombudsman to handle competition complaints, has met with similar resistance.

As if the attentions of one competition watchdog were not enough, the Office of Fair Trading, too, has two big investigations pending into supermarkets' pricing practices—one on milk and other dairy products, the other on tobacco. And there is interest from higher up too. More than 400 members of the European Parliament have asked the European Union's competition enforcers to investigate concentration in Europe's supermarket sector, arguing that a handful of retailers may be acting as "gatekeepers" between food producers and consumers, to the detriment of both.

In the meantime, Tesco will be exploring prospects in financial services. And who is to say it's wrong? For the moment, at any rate, Britain's biggest retailer looks a safer bet than most of its banks.

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Bagehot

The loneliness of the long-distance frontrunner

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David Cameron may have to start again, almost from the beginning

Illustration by Steve O'Brien

David Cameron

BEING a frontrunner can be tougher than it looks. In politics, as in sport, a lead that looks luxurious can instead create anxiety: about whether to play safe or risk an extra burst of effort, and whether your opponents are really as far behind as they seem. Such were the concerns with which David Cameron, the leader of the Conservatives and champion of the opinion polls, arrived at his party's annual conference in Birmingham. By the time it closed on October 1st the Tories were beginning—but only beginning—to face up to a much more disorienting worry: that the familiar political track they had been cantering around may soon be replaced by a new and unpredictable obstacle course.

That galling reality seemed to dawn on Mr Cameron on September 30th, when he made a short unscheduled statement on the financial turmoil. He foreswore all jokes; the cardboard cut-outs of David Miliband, the foreign secretary, holding a banana, which had been scattered around the conference venue, had mysteriously been removed. Mr Cameron likewise ditched the Tories' usual attacks on Gordon Brown's irresponsible borrowing and fixed instead on two new villains.

The first were renegade financiers, who were promised "a day of reckoning". The tone echoed George Osborne, the shadow chancellor, who had earlier insisted the Tories would not be "bedazzled by big money" ("because you've already got it", thought many people in the hall). This was a collective effort to strike a critical, if still supportive, attitude towards capitalism—a tricky duality encapsulated in Mr Cameron's curious defence of what, eschewing the toxic word "market", he called the "free-enterprise system". The other villain was another erstwhile Tory friend, America. Though he borrowed from both John McCain's theatrics and Barack Obama's rhetoric, Mr Cameron vowed to do better than the fractious Americans, co-operating with the government to safeguard what is left of Britain's financial architecture.

This offer was as specious as it seemed statesmanlike: unlike American congressmen, Mr Cameron has no formal role in economic policy, and (unsurprisingly, given their palpable loathing for each other), Mr Brown seems disinclined to grant him much of an informal one. Nevertheless, Mr Cameron showed again that he can be nimble in a crisis, and that he can do solemn as well as perky. He reinforced this impression in his main speech on October 1st when he argued that, in times of trial, character and judgment (ie, his) were more valuable than the dubious experience Mr Brown likes to tout.

This, however, was only the first hurdle of the new race. “Plan for change” was the slogan of the conference. Mr Cameron successfully changed its mood to match the economic bleakness. But he may yet have to reappraise his entire political strategy.

Dave’s new decathlon

No one knows precisely how painful or prolonged the damage to Britain’s economy will be, nor what its political consequences might consist of. History suggests that the political fallout of cataclysms can be surprising: when the Berlin Wall fell and communism collapsed, it seemed that European parties of the left might crumble too; instead they flourished. And perhaps the agony of capitalism will counterintuitively benefit parties of the right.

Or, as in the 1930s, the results may be radical and dramatic, which in Britain might mean the revival and electoral resurgence of an old-fashioned interventionist Labour Party. (The ongoing mayhem has already boosted Mr Brown’s ratings—though in the end it may help to wreck Labour, by forestalling a move to depose the prime minister and ensuring that he stays in office to lead his party to defeat.) Or it may be that, when the dust and the FTSE eventually settle, the party-political effects are seen to be broadly neutral, as has been the case with, say, the war in Iraq.

But in any event, it seems likely that all the hard work Mr Cameron has put in since he became party leader in 2005—all the patient and occasionally ridiculed rebranding and “detoxifying”, the windmills and the cycling, the huskies and the hoody-hugging—will count for little. All the theorising about the “post-bureaucratic state” and a progressive Conservatism, all the persuasively honed arguments for education reform, are likely to be obscured by a new set of political preoccupations: rising (perhaps vertiginously rising) unemployment and home repossessions, shrinking tax receipts and a deficit growing much more sharply than the Tories expected.

It is not yet clear whether they are ready for this new contest. Mr Osborne sombrely acknowledged that “the cupboard is bare,” and thus that a future Tory government would have little fiscal room for tax cuts. Mr Cameron talked vaguely about doing “difficult and unpopular things” and praised Margaret Thatcher, a byword for painful but necessary reform. But the two men may soon need to go farther than simply promising fiscal restraint (to be policed, they say, by a gimmicky new quango, of a sort they otherwise pledge to cut back). They will need policies to protect and save jobs, and others to save and raise cash. If Mr Brown manages to match his statist talk with new measures to help people through the downturn, the Tories will need answering ideas. Mr Cameron is right to say that experience is not enough. But neither is character alone.

Party conferences are always oddly cocooned—insulated little festivals of eccentric rants, worthy debates and dutiful boozing. This one sometimes felt almost surreal in its detachment. Platform speakers raised automated cheers with boilerplate denunciations of health and safety and European regulations. Delegates guffawed over cocktails like passengers on the Titanic, or perhaps like revellers in Weimar Germany. Most of Mr Cameron’s big speech was the usual opposition hybrid of excoriation and optimism. The Tories may realise that the race has changed, but they have yet to appreciate quite how drastically.

Apologies

Who's sorry now?

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Who should apologise to whom, for what and how?

PA

DOES Wall Street owe the people of America an apology? That was Senator Sherrod Brown's suggestion to Ben Bernanke and Hank Paulson during a Senate hearing last week. If so, the humbled titans of finance will be in good company; institutional apologies have mushroomed in past years (see table). British Christians, for example, have expressed public contrition for slavery (pictured above) and have even considered apologising for scepticism about evolution. Nicolaus Mills, an American commentator, calls the fashion for saying sorry a "global culture of apology". That may be an overstatement: public kowtows are still rare compared with the manifold wrongs of the past. The bigger question is what, if anything, they mean.

Say what?
Selected apologies

By	To	Reparations/Compensation	Date
(West) Germany	Israel	DM3bn (1952 prices)	1952
United States	Interned Japanese Americans	$1.6bn (1988 prices)	1988
New Zealand	Maori tribes	NZ$112m (1995 prices)*	1995
United States	Rwanda	No	1998
Australia	Forcibly removed aboriginal children	No	2008
Canada	Forcibly removed aboriginal children	C$1.9bn (2006 prices)†	2008
Vatican	Women	No	1995
Vatican	Orthodox Christianity	No	2001
JPMorgan Chase	African-Americans	No	2005

Source: *The Economist* *and 39,000 acres †Settlement preceded apology

An individual's private apology, if sincere and well timed, may draw the sting from debilitating feelings of humiliation, guilt and vengeance. Public remorse has more impact, but may sound opportunistic: a political trick, or a showbiz stunt. (Think of former presidential candidate John Edwards's apology for infidelity, or the singer Janet Jackson's supposed contrition for a "wardrobe malfunction" that exposed a nipple to horrified American television viewers).

Apologies for past wrongs by present-day institutions are trickier still. Jonathan Sumption, a London lawyer and historian, calls them “a vulgar anachronism”—in effect, he says, “a rebuke to the past for not being more like the present”. Trading apologies and forgiveness on behalf of dead people sounds phoney—especially when the issue is centuries old (such as Viking rape and pillage in Ireland, which Denmark’s culture minister Brian Mikkelson bemoaned in 2007). Collective guilt is an odd idea even in the present (and has often been, Mr Sumption notes, the root of just the kind of massacres for which people are now apologising). Yet at a minimum, owning up to what happened in the past, and learning lessons from it, should benefit everyone.

Even if all sides do accept that an apology is needed, the wrong kind (limited, grudging or insincere) can backfire. Japan’s repeated expressions of regret for wartime atrocities jar in countries such as China and South Korea. They note sourly Japan’s continued public veneration of convicted war criminals.

Successful apologies are usually a tactic of international or national politics, particularly when a new leader wants to distance himself from past mistakes (his own, or preferably other people’s). Italy has just apologised to Libya and paid reparations for colonialism (in exchange for energy deals and co-operation on migration). America’s ex-president Bill Clinton and Britain’s former prime minister, Tony Blair, were skilled in the theatre of public contrition on issues such as slavery. South Africa’s president F.W. de Klerk apologised for apartheid in 1992; Nelson Mandela then apologised for atrocities committed by the African National Congress. A Truth and Reconciliation Commission recorded individuals’ suffering and gave perpetrators a chance to confess and say sorry.

So what makes a public apology successful? Melissa Nobles, a political scientist at the Massachusetts Institute of Technology who specialises in apologology (our word), says that they can give official backing to a particular view of history, help contain political grievances peacefully and encourage public-spiritedness among alienated parts of the population.

But apologies don’t come free. They raise the vexed question of compensation: not just money, but the promise of different legal treatment, including the right to sue for redress. Canada has recompensed indigenous children removed from their homes; so has the state government of Tasmania. America and Canada have compensated ethnic Japanese citizens interned during the second world war.

But these were tightly defined groups that could be compensated fairly cheaply. The former conservative government of John Howard in Australia long resisted a general public apology to aborigines, fearing it would encourage divisive, race-based politics (such as quotas). He proposed a “motion of resolution” in 1999 that did not mention the word “apology”. It was widely judged unsatisfactory and his successor, Kevin Rudd, apologised properly this year.

Still, fear of the legal consequences of saying sorry may be overblown. Mr Rudd’s apology explicitly stated that it would have no legal import; a landmark court case confirmed that previous apologies by Australian states were protected by parliamentary privilege. America’s apology for slavery was a cashless one.

The tip of the iceberg

For all the recent apologies, many are still outstanding. Turkey has recently thawed relations with Armenia. But the question of 1915 (genocide or just a massacre?), and what modern Turkey should say about it, is still open. Few expect anything like the contrition Germany showed to the Jews or the reparations it paid to Israel. By saying sorry to one another Israel and the Palestinians might promote peace but also raise new complications—if, for example, the Palestinians construed an Israeli “sorry” as endorsing the right they claim to return to former homes. Some British public figures, such as Mr Blair, have gone in for public breast-beating about colonialism. Other former empires seem indifferent. Belgium, France, Portugal, Russia and Spain may think they have got over their imperial past; their former colonies do not. Victims (and their descendants) have longer memories than perpetrators: it is easier to forget than to forgive.

And what about apologising to the millions whose jobs and savings are threatened by the financial tsunami? Hank Paulson, America’s treasury secretary and a former boss of Goldman Sachs, sidestepped Senator Brown’s question by saying that he shared the general outrage and that there was “a lot of blame to go around”. True—but it will take a lot more than an apology to make amends.

Nuclear security

Who wins, nukes

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Preventing nuclear trafficking is easier than policing it

NO NUCLEAR material, no bomb. It’s as simple as that. Hence the renewed, unanimous call by the United Nations Security Council for Iran to cease its suspect uranium-enriching and plutonium work. The same is true for terrorist groups such as al-Qaeda, known to be seeking nuclear materials and other weapons of mass destruction as a “religious duty”. The difference is that Iran can produce its own fissile material; terrorists have to steal theirs.

Keeping nuclear weapons out of the hands of terrorists therefore involves a lot of gumshoe work to clamp down on traffickers. But it would surely be better to plug the security holes that allow the stuff to leak out in the first place. Changing the nuclear industry’s security culture is the immodest aim of the newly launched World Institute for Nuclear Security (WINS).

One measure of the scale of the plugging needed comes from the nuclear trafficking database of the International Atomic Energy Agency (IAEA), the UN’s nuclear guardian. From 1993, when the IAEA first started counting, to the end of 2007, there had been 1,340 recorded incidents of the misuse, theft or loss of nuclear materials; 18 of these involved highly enriched uranium (HEU) or plutonium, some in quantities as large as kilograms (it takes up to 25kg of HEU or 8kg of plutonium to make a bomb).

Most such cases have involved material filched from ill-guarded sites in Russia after the collapse of the Soviet Union. The number of serious incidents recorded has been falling. That may not be as comforting as it sounds. Traffickers are probably getting cleverer; by its nature, illicit trade goes largely undetected. But it helps that America has been assisting Russia and others with security upgrades, including better fences, surveillance equipment and radiation monitors, as well as security training, at military and civilian sites where nuclear materials are used or stored.

Now two things are about to change. Security upgrades in Russia are to be completed this year. It remains to be seen whether improvements will last once the dollars and the chivvying stop. Meanwhile an industry using deadly materials spread across more than 40 countries may be about to expand farther and wider, as from Venezuela to Vietnam governments contemplate nuclear power as a source of cleaner energy.

The international legal apparatus to deal with this looks robust. The UN’s resolution 1540 obliges all governments to stop nuclear (and chemical and biological) bomb-making materials falling into terrorist hands. Some 75 countries have banded together in a supporting Global Initiative to Combat Nuclear Terrorism. The IAEA, meanwhile, can help governments with advice: protecting the Beijing Olympics, for example, against radiological attack, disposing of radioactive materials found in factories and hospitals, and fixing security breaches. It is also boosting the academic study of nuclear security.

But the weakest links will always be sites where materials are kept. WINS is a place where for the first time those with the practical responsibility for looking after nuclear materials—governments, power plant operators, laboratories, universities—can meet to swap ideas and develop best practice.

Start-up cash comes from America’s Department of Energy, the Nuclear Threat Initiative, a private Washington-based group that has long promoted nuclear clean-up activities around the world, and the Norwegian government. Eventually WINS will have to live on support from those who find its services useful.

It took the Chernobyl nuclear disaster in Ukraine for the nuclear industry to focus collectively on reactor operating safety. Preventing security lapses that would mean an even bigger catastrophe ought to be a winning cause.

Introduction

The battle of hope and experience

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Will America choose the old hero who favours tax cuts for business and the rich and backed George Bush's wars? Or the young man who promises health care for all, a swift exit from Iraq and more money for the average worker? As America's financial system buckles, this ought to be an unlosable election for the Democrats. But it isn't

IT HAS been a time of miracles and wonders. Hillary Clinton, the "inevitable" Democratic nominee, was beaten by a man who was barely out of law school when she was trying to reform the nation's health-care system; and that man, Barack Obama, has become the darling of the world. John McCain, a senator whose campaign was given up for dead last year, improbably surged past all his rivals to seize the Republican nomination. Voters in November will pick either a black president or a female vice-president, breaking new ground either way. And most surprising of all, at a time when the Democrats surely cannot lose, they still just might.

Only once in the past half-century has a party been awarded three consecutive terms in the White House. That was in 1988, after Ronald Reagan's two terms, when the economy was strong and the president was still popular. Neither remotely holds true now. The economy may not quite be in recession, but it certainly feels that way. House prices are tumbling, petrol and grocery prices are painfully high and wages have stagnated for years. The September meltdown of much of Wall Street has put an unexpected focus on the candidates' grasp of the complex world of high finance. The wars in Iraq and Afghanistan drag on. By rights, Mr McCain should be shuffling towards certain defeat. Yet the polls are still very close. The main reason is that the Democrats have picked as their standard-bearer Mr Obama, a man of great gifts but significant weaknesses.

Mr Obama writes brilliant speeches and delivers them beautifully. He attracts huge crowds, stirs their passions and moves them to tears. Yet he is no crude demagogue. He approaches policy questions with an admirable mix of intellect and pragmatism. His advisers marvel at his capacity to weigh complex arguments and pick solutions that seem both sensible and politically feasible.

He promises much. He would withdraw American troops from Iraq as fast as is practicable. He would increase the size of the army and send more troops to Afghanistan. He would close the prison at Guantánamo Bay. Domestically, he would offer Americans near-universal health care. He would raise taxes on the rich and on businesses, trim them for the great bulk of the middle class and offer numerous handouts. He would set up a cap-and-trade system for curbing carbon emissions and lavish cash on alternative energy.

To many of his fans, Mr Obama's allure owes even more to his persona than to his policies. He is an athletic 47. Half-black, half-white and raised by a single mother, his rise from modest roots embodies the American dream. Not only does he preach racial reconciliation; his election would help achieve it. And a generation of black children would grow up with an ideal role model: a black president with a loving, intact family.

Mr Obama's election would also help mend America's shredded relations with the rest of the world, though probably less than his foreign fans imagine. Unlike George Bush, he soothingly espouses international co-operation. His nuanced manner reassures Europeans. His surname is African, his middle name is Arabic, he has Muslim forebears, he grew up partly in Asia and his skin colour is close to the global average. A recent poll of 22 countries by the BBC found that people in all 22 of them preferred Mr Obama to Mr McCain.

But only Americans can vote in American elections, and many have doubts about Mr Obama. He has the thinnest résumé of any nominee in living memory. Eight years ago, when he ran for a seat in the House

of Representatives, his opponent, a former Black Panther, dismissed him by asking: “Just what’s he done?” Mr Obama was then a lowly state senator, and had also worked as a lawyer and a community organiser. Voters deemed this to be insufficient preparation for Congress. Mr Obama lost by 31 percentage points.

In 2004 he was elected to the United States Senate. But many Americans hesitate to hire as the country’s leader someone with no executive experience besides running the Harvard Law Review and a series of election campaigns. Others worry that he is not as nice or principled as he seems. He won that state Senate seat by having all his rivals thrown off the ballot. He cosied up to Chicago’s machine politicians. His pastor for two decades preaches “God damn America”. For all Mr Obama’s rhetoric about reaching across the partisan divide, he has never stood up to his party to accomplish anything substantial. For all his talk about uniting his country, he has become an unexpectedly divisive figure.

McCain, again

The alternative is Mr McCain. Though quick-witted on the stump, Mr McCain seems less intelligent and less eloquent than Mr Obama. His age is against him: he would be the oldest first-term president ever inaugurated, and he has had recurrent bouts of cancer. He has a volcanic temper that he struggles to control. Many people fear that he is a warmonger at worst, at best a prickly individual with neoconservative tendencies who will do little to mend fences with the world. His grasp of the details of economics and finance is shaky, to say the least.

But Mr McCain is also a brave politician, who has often tried to do the difficult not the expedient thing. He would stay the course in Iraq, arguing that a hasty withdrawal would spark chaos. He would stand up to Russia and Iran. Like his rival, he would close Guantánamo.

On the economic front, whereas Mr Obama flirts with protectionism, Mr McCain is a staunch free-trader. He endorses low taxes, though the rich get most of the breaks. In general he favours light regulation, but he now agrees with Mr Obama that Wall Street needs firmer oversight. Also like Mr Obama, he proposes a cap-and-trade system for greenhouse gases, but he would give away the permits, not auction them. His health-care plans emphasise using competition to curb costs rather than expanding coverage.

Mr McCain’s domestic platform may be beside the point, however, since Congress will be Democratic and unlikely to pass his proposals without rewriting them. On the other hand, for many moderate voters, the best argument for Mr McCain is that a Republican president and a Democratic Congress would check and balance each other. In the past, divided government has led to greater fiscal prudence, since presidents are more likely to veto the other party’s wasteful spending. Getting both parties to share the pain is also the only realistic way to tackle tough long-term problems, like the looming bankruptcy of Social Security (public pensions) and Medicare (public health care for the elderly).

If voters made up their minds according to each party’s stated policies, Mr Obama would probably be a shoo-in. But they do not. The president is both chief executive and symbolic head of state. Voters want someone who has the extraordinary talents necessary to do the job, yet who also seems ordinary and likeable. Cultural cues matter hugely. So does evidence of sound judgment and strength of character.

Mr Obama wins top marks for raw talent. He can also claim sound judgment: though no pacifist, he opposed the Iraq war from the start. Mr McCain retorts that he backed the “surge” before it was popular, when Mr Obama tried to block it.

The two men’s life stories appeal to different groups. Mr McCain is a war hero who endured years of torture in Vietnam. He has often defied his own party in pursuit of centrist policies, such as banning torture, welcoming immigrants and tackling climate change. Mr Obama is more of an enigma. His voting record is one of the most liberal in the Senate, but in his books, he tends to present two sides of each policy argument without reaching many firm conclusions. During the campaign he has tacked to the centre. Even professional observers are now thoroughly unsure what he stands for.

Mr Obama has addressed some of his weaknesses by picking Joe Biden as his running-mate. Mr Biden has been a senator for 36 years and knows a lot about foreign policy. His working-class roots appeal to some who find Mr Obama detached from their problems. But he has had less effect on the race than Mr McCain’s risky—and, some say, deeply cynical—choice of Sarah Palin, the governor of Alaska.

There is still a month to go and the economy is, to put it mildly,

Unlike Mr McCain, Mrs Palin knows little about national or international politics. But as a working mother of five who grew up shooting moose for the freezer, she appeals to small-town voters who feel condescended to by Democrats. And as a born-again Christian and passionate pro-lifer, she thrills social conservatives who have never warmed to Mr McCain. But she appals a lot of independent voters, who dislike her conservative views and worry about her evident inexperience, should she ever have to step into the 72-year-old Mr McCain's shoes. The “Palin effect” was huge at first, but it quickly started to fade.

volatile

Meanwhile, no one knows how race will affect the election. Many people, black and white, will back Mr Obama because he is black. Many will oppose him for the same reason, though few will admit as much. There is still a month to go, the presidential and vice-presidential debates still need to sink in, and the economy is, to put it mildly, volatile. After a campaign that has already lasted more than two years, it seems impossible to predict who will win. But no one can complain that Americans are not getting a clear choice.

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The Economy

A choice of remedies

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Will voters opt for redistribution or another dose of supply-side medicine?

Illustration by Sarah Hanson

WITH America in or near recession, the economy has muscled its way to the top of most people's priorities. Yet voters this autumn will not just be deciding which man they trust to manage the economy. They will also vote more broadly on what role they want the government to play in their lives.

For decades both Democrats and Republicans have broadly espoused less regulation, freer markets and free trade, though their conviction has waxed and waned with the economic weather. That consensus is now under threat. Average wages have stagnated since 2001 because of high energy prices, rising health-care costs and widening inequality. Many blame free trade or immigration. The credit crisis has further undermined the consensus by exposing serious flaws in America's financial system and precipitating dramatic intervention by the government in the markets (see article).

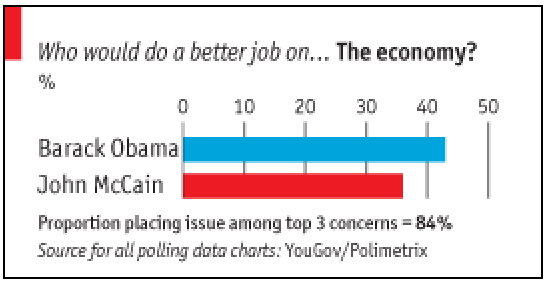
John McCain and Barack Obama offer voters starkly different economic philosophies. Mr McCain thinks the economy will grow faster with less regulation, more free trade and lower taxes on the wealthy and on capital. Mr Obama thinks the benefits of growth will be more widely shared if there is more government oversight, a less enthusiastic embrace of free trade and a tax system that reverses some of the widening trend in inequality.

Neither man is monolithic in these views. Mr McCain opposed George Bush's tax cuts in 2001 because the benefits went mostly to the wealthy; he opposed them in 2003 because they depleted the Treasury while the country was at war, though he has since come round to them. He has attacked the "extravagant salaries and severance deals of CEOs". He famously allowed that "economics is not something I've understood as well as I should," and this year has brought evidence that he wasn't joking. He backed a petrol-tax holiday despite the misgivings of economists, including some who advise him. His pledge to add huge new tax cuts to Mr Bush's while simultaneously balancing the budget is not credible.

Mr Obama calls himself a "pro-growth, free-market guy", despite opposing most of Mr Bush's trade deals, voting in favour of farm subsidies and frequently veering into populist rhetoric. "In the long run, we cannot have a thriving Wall Street and a struggling Main Street," he argued in August. Still, in contrast to Mr McCain, Mr Obama has moved closer to the centre during the campaign. He now proposes keeping some of Mr Bush's reduction in dividend and capital-gains taxes, a concession to the economic consensus that such taxes discourage investment.

The first challenge either man will face is to restart the economy. Mr Obama has been more activist, calling for $50 billion to be spent on public infrastructure and aid to fiscally strapped states and for tax rebates of $1,000 per family, financed by a five-year tax on oil-company profits. Mr McCain was sceptical at first about the wisdom of additional stimulus, but became more open to the idea as the crisis worsened.

The two men's long-term ambitions for the economy are best illustrated by their plans to revamp the tax system: plans that are urgent because Mr Bush's 2001 and 2003 tax cuts all expire at the end of 2010. Of course, neither will deliver precisely what he promises thanks to the constraints of deficits, congressional horse-trading and the flow of unexpected events.



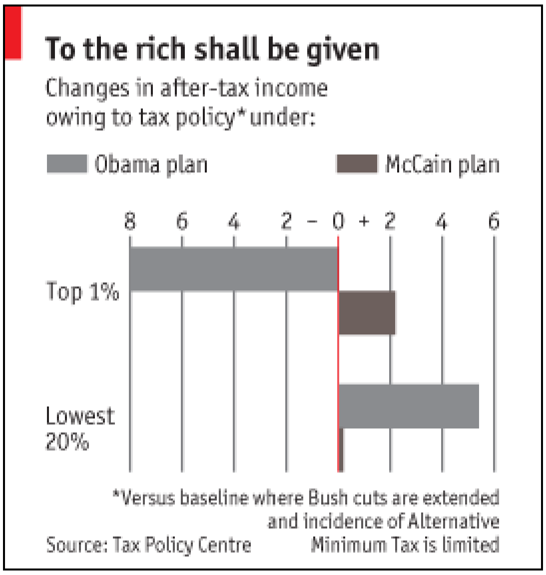
The nitty-gritty

Mr Obama's tax plan revolves around keeping Mr Bush's tax cuts for households earning less than $250,000 a year and reversing them only for those who earn more. These rich families would see their tax rates return from 33% and 35% to the Clinton-era 36% and 39.6%. Mr Obama would retain Mr Bush's 15% tax rate on dividends and capital gains for those earning less than $250,000—but raise it to 20% for those with more.

He has also proposed raising the Social Security payroll tax on those earning more than $250,000 by two to four percentage points, although only as part of a broader overhaul of the programme and not until 2019. Beyond that, he would create or expand a variety of tax credits for low- and middle-income workers. He would also exempt old people earning less than $50,000 a year from paying any income tax. The Tax Policy Centre, a non-partisan research group, reckons that under his plan some 80% of American households would pay less tax than they do now while 10% would pay more. His opponents imply his plans would increase taxes on middle-class workers, but this is plainly not true.

For his part, Mr McCain would keep in place all Mr Bush's tax cuts on wages, capital gains and dividends, while boosting the exemption for dependants from $3,500 to $7,000. He would also dramatically up the ante by chopping the top corporate tax rate from 35% to 25% (though eliminating some deductions). For five years, he would let companies immediately write off against profits the full cost of equipment meant to last three to five years.

Mr Bush's tax cuts widened the gap in after-tax income between the rich and the poor at a time when the gap was widening anyway because of economic forces. Mr Obama would reverse some of that widening; Mr McCain would add to it. The Tax Policy Centre estimates that, under Mr Obama's plan, the after-tax income of the bottom 20% of people would be 5.4% higher while that of the top 1% of people would be 8% lower. Under Mr McCain's plan, the bottom 20% would see their after-tax incomes rise just 0.2% whereas the top 1% would see theirs rise 2.2%. (See chart, but note that Mr McCain's team disputes these figures.)



Over the long haul

Taken at face value, Mr McCain's tax plan would seem better designed to boost long-term economic growth. Lower taxes on capital gains, dividends and corporate profits and immediate expensing of equipment all reduce the cost of capital, encouraging firms to invest more. That would raise workers' productivity and, eventually, wages. By contrast, Mr Obama's tax increases on the wealthy might discourage them from earning more. His widespread use of tax credits might also give workers less incentive to earn more, since that would cost them some of their credit.

But such effects may not count for much. There is no evidence that Bill Clinton's 1993 tax increases stopped the wealthy from working harder. Mr Bush's own Treasury estimated that all his tax cuts would boost GDP a tiny 0.7% after many years, and then only if they were paid for by spending cuts, which they weren't.

The two candidates largely sidestep some of

Moreover, the beneficial impacts of Mr McCain's tax cuts on investment could be entirely cancelled out by the borrowing that would be needed to finance a bigger deficit. The Tax Policy Centre estimates that his tax plans would boost the national debt by $758 billion by 2018, assuming that Mr Bush's tax cuts

remain in place and the Alternative Minimum Tax—a parallel tax system aimed at the wealthy—doesn't ensnare a growing share of the middle class. Such borrowing pushes up interest rates and thereby crowds out more productive private investment.

the most vexing problems

Mr McCain has promised to balance the budget in his first term (ie, by 2013) but offers no credible way of doing this, especially since the deficit is already projected to top $400 billion, or about 3% of GDP, next year. Mr Obama's tax plans, relative to the same projections, would reduce the debt by $748 billion.

Mr McCain and Mr Obama both plan to reduce the deficit through spending cuts, but are short on details. Mr McCain has some credibility on this subject, since he voted against farm and ethanol subsidies (Mr Obama voted for both), castigated bloated Pentagon procurement and refused to ask for earmarks (funds set aside for a legislator's favourite projects). Still, this may not count for much. Earmarks are symbolically potent but fiscally inconsequential, since they mostly parcel out spending rather than alter its level. A better reason to expect spending discipline from Mr McCain is that he will have fewer qualms than Mr Obama about vetoing bills sent to him by Congress, which seems certain to be more strongly Democratic than it is now.

For all the detail in their economic plans, Mr Obama and Mr McCain largely sidestep some of the most vexing economic problems. As the ratio of retirees to workers grows and the cost of health care rises, Medicare and Social Security will eventually suffocate the budget. Neither man has explained how they will avoid that catastrophe. Mr McCain wants workers to have personal investment accounts as part of Social Security but hasn't explained how to make the overall programme solvent. He does, at least, offer some interesting ideas on cutting health-care costs. Both candidates agree that a solution needs to be bipartisan.

Campaigns are not the place to expect details on the pain a candidate plans to inflict. Nor can either predict the surprises that will rearrange their priorities. But America faces hard choices on spending and taxes. Mr Obama's and Mr McCain's platforms offer some guidance, at least, as to how they will approach them.

... Next article

Economist.com OPINION

Regulation and trade

Changing the rules

Oct 2nd 2008
From The Economist print edition

The candidates offer divergent responses to the credit crunch and differ sharply over free trade

Illustration by Sarah Hanson

AT THE best of times, economic regulation does not lend itself to close examination in election campaigns. Regulation, like economics itself, is about trade-offs and judgment, whereas candidates need to put things in black and white.

That is even more so in this election, when Barack Obama and John McCain are being forced to respond to events that trained economists and bankers barely understand: a housing crash linked to mind-numbing financial instruments, a brush fire of insolvency among financial firms, and a proposed $700 billion bail-out on unclear terms.

The two men's divergent philosophies on the role of regulation, government intervention and free trade offer important clues as to what they would like the world to look like when the dust settles. These, at heart, are different aspects of one central question: just how free should the free market be? Since Mr McCain has always been on the side of free markets and this crisis has often been blamed on the excesses of unbridled capitalism, Mr Obama has had the chance to seize an advantage.

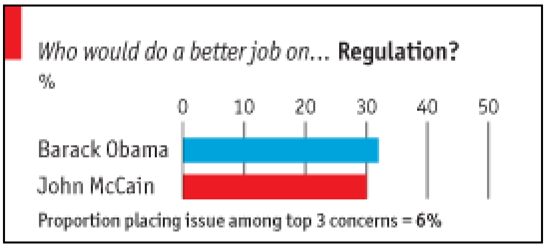
The core of the crisis that has engulfed the final weeks of the campaign is that falling prices of property and other assets are turning the loans used to finance them bad. These loan losses erode the capital of financial institutions, making some fail and others wary of lending. In theory, this cycle should end once property prices fall to a level that entices a fresh wave of buyers. But a lot of damage can be done in the meantime, as the withdrawal of credit leads to more economic weakness and so to even lower asset prices, which may eventually fall below even bargain levels.

The Great Depression in the 1930s and the American, Scandinavian and Japanese banking crises of the 1990s eventually required the government to take over many failing institutions to remove bad debts from the system. So how much more could and should the federal government be doing?

The Federal Reserve's bail-out of Bear Stearns and the Bush administration's takeover of Fannie Mae, Freddie Mac and the insurance group AIG were reluctant steps to stem the damage; the line was drawn at saving Lehman Brothers. But the Bush administration's latest plan for stabilising the markets, a $700 billion buy-out of bad debt from struggling banks, is a much bigger proposition. While the two candidates' utterances on such actions change with the flow of events, at heart their positions come down to how much public money they think should be committed to getting out of it, who should get it, and who else should benefit.

Mr Obama and Mr McCain have both said taxpayers' money should not be used to bail out the firms and executives whose behaviour sparked the crisis. But Mr McCain, like most

Republicans, has generally been the more hostile. He praised the Treasury for not using public money to prevent Lehman's bankruptcy. But he has also chopped and changed. Initially he opposed a bail-out of AIG, then supported it after the fact. On September 18th he called for the creation of a "mortgage and financial institutions trust" to prevent weak institutions from becoming insolvent. He then attacked the administration's plan.



Mr Obama has been more neutral on the bail-outs. He says that he wants any assistance for Wall Street firms to be paired with "equally swift and serious" help for the struggling families of Main Street, and that any rescue plan for banks must be temporary.

Their differences were already apparent earlier this year, when Mr Obama strongly backed a Democratic proposal to commit up to $300 billion to restructuring the mortgages of troubled homeowners. Mr McCain proposed a smaller plan. "It is not the duty of government to bail out and reward those who act irresponsibly, whether they are big banks or small borrowers," he said in March. He eventually dropped his opposition to the larger plan, as the Bush administration did.

These opposite starting positions will matter if the crisis gets ever worse. The sooner government intervention occurs, the more effective and, in the end, cheaper it is likely to be. But intervention that proves unnecessary creates moral hazard and big liabilities.

Will either allow further nationalisations if the banking system again comes under threat?

Mr Obama has addressed the crisis earlier and in more detail than Mr McCain. He has laid the lion's share of blame on unscrupulous lenders, mortgage-industry lobbyists and inadequate oversight of credit-rating agencies and financial institutions, and was writing letters to this effect more than a year ago. He has made it clear that, if elected, he would regulate Wall Street more tightly, both with stiffer capital requirements and closer oversight, especially of firms that borrow from the Federal Reserve. He would streamline the country's many regulatory agencies and create "a financial market oversight commission" to anticipate future crises.

In the Senate, Mr McCain has never played a leading role in financial issues, but his instincts have always been against more regulation. He told the *Wall Street Journal* in March that although the subprime crisis revealed a role for oversight, "I am fundamentally a deregulator." He has tended, more than Mr Obama, to blame the crisis on an impersonal housing bubble, rather than on flesh-and-blood financiers.

After Lehman's failure on September 14th, however, Mr McCain turned more populist. He promised to end "reckless conduct, corruption and unbridled greed" on Wall Street (which he called a casino) and to "enact and enforce reforms": but he declined to give any specifics beyond firing the head of the SEC. For Mr McCain to reinvent himself as a fan of re-regulation is a stretch, since he has spent the past decade pushing in the opposite direction. He voted, for instance, in favour of the 1999 bill that abolished Glass-Steagall and let retail and investment banks go into each others' businesses.

The terms of trade

While free trade is linked more philosophically than directly to the deregulation that has helped to spawn the current financial crisis, its popularity has also suffered under the economic pressures of recent years. In a recent Pew Centre poll, 48% of Americans said trade agreements are a bad thing, and just 35% thought they were good—the worst margin in at least a decade.

Free trade is also deeply unpopular with Democrats in Congress, whose numbers are expected to grow after the election. That means either president will face an uphill battle getting new agreements through.

Mr McCain's support for free trade is consistent and uncomplicated. According to the Cato Institute, a conservative think-tank, he has voted in favour of lower barriers on 88% of the 40 major trade bills he has faced since 1993. Mr Obama has done so on just 36% of the 11 he has faced since joining the Senate in 2005. Mr McCain voted for the Central America Free Trade Agreement and supports the pacts with South Korea and Colombia that the administration has signed but the Senate has not yet ratified. Mr Obama opposed all three and has talked of renegotiating NAFTA, America's free-trade agreement with Mexico and Canada, to insert labour and environmental standards.

In his view, free trade can advance only once workers no longer feel their rights and wages are threatened by it: “There is nothing protectionist about demanding that trade spreads the benefits of globalisation as broadly as possible,” he says. His advisers claim Mr Obama is more likely to get trade agreements approved than Mr McCain because he is more willing to link them to labour rights, environment protection and worker retraining. Mr Obama also wants to strengthen unions, by for example allowing recognition of a union without a vote if enough workers have signed union cards (Mr McCain opposes this). But a rejuvenated labour movement may be a stronger opponent to free trade, and other countries may reject trade pacts with too many conditions.

In Mr Obama’s view, free trade can advance only once workers no longer feel threatened by it

Even if no new agreements are signed, the next president will play a crucial role in responding to protectionist pressure from workers, companies and their backers in Congress. Mr McCain’s history, which includes opposition to farm and ethanol subsidies, suggests he will oppose such pressure. Mr Obama, however, has seldom gone against his party on trade (or anything else). At a recent conference, campaign advisers were asked whether their candidates would veto a protectionist bill from Congress. The McCain adviser, Kevin Hassett, said yes. The Obama man, Gene Sperling, said this: “If Senator Obama believes that a bill was going to be bad for jobs or for the economy, he would veto it.”

Both men would be likely to make full use of the threat of congressional action as a lever to extract concessions from trading partners—as the Bush administration did in persuading China to let its currency rise. Historically, presidential candidates become free traders once in office, according to Douglas Irwin, a trade historian at Dartmouth College. Trade deals are a good way of cementing alliances; and they make excellent photo opportunities.

In the end, the fate of free trade in the election hangs on this question: is it more likely to advance under an unabashed advocate like Mr McCain, or a sceptic like Mr Obama who fancies himself better able to sell it to his fellow sceptics? To free-traders, trusting in Mr Obama requires a lot more faith.

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Foreign policy

The best of enemies

Oct 2nd 2008
From The Economist print edition

On a surprising range of foreign-policy issues, the rivals have morphed into each other. But differences remain

Illustration by Sarah Hanson

VIN Weber, a former Republican congressman for Minnesota, once joked that Americans treat foreign policy much as they treat dentistry—something they would rather not think about unless they have to. The first three presidential elections after the end of the cold war, in 1992, 1996 and 2000, saw little discussion of the world beyond America's borders. The economy trumped international affairs, the culture wars diplomacy. Even in 2004, when America was really at war, values seemed to matter much more than abroad did.

This year will be different. Foreign policy will define the election almost as much as America's troubled economy. The next American president will inherit the most difficult international situation since Richard Nixon won power in 1968: two nasty wars, in Iraq and Afghanistan, in their fifth and seventh year respectively; an Iran bent on acquiring nuclear weapons; instability in Pakistan; deeply strained relations with a prickly Russia; rivalry with booming China; a catastrophic drop in America's standing around the world; and a backlash against globalisation.

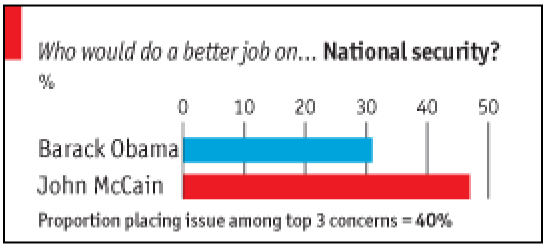
The candidates, Barack Obama and John McCain, are the products of different worlds. Mr Obama emerged from a liberal chrysalis—Ivy League universities and a spell as a community organiser in inner-city Chicago. He was six during the Tet offensive. Mr McCain is part of a military dynasty—the son and grandson of admirals and father of a son who has served in Iraq in the marines. The formative experience of his life was being shot down in Vietnam and spending five-and-half years in the Hanoi Hilton. Mr Obama opposed the Iraq war from the start; Mr McCain backed regime change before George Bush became president.

Yet despite all this, the two candidates see eye-to-eye on many big issues. First, both genuinely understand (as Dick Cheney, say, cannot) that the next president must strive to improve America's global image. The Bush years have seen a catastrophic decline in pro-American sentiment around the world. Only 31% of Germans have a favourable view of the United States. Positive views of America have dropped to 19% in Pakistan and to a miserable 12% in Turkey. A big majority of Americans agree that their country's reputation has been badly damaged in the Bush years. This not only makes it difficult for America to exercise moral leadership; it also hinders its exercise of hard power. In the run up to the invasion of Iraq the Turkish government felt obliged to refuse American troops permission to operate from its soil.

Things can only get better

The good news is that either candidate is well-placed to improve America's image. Mr Obama represents everything that educated Europeans like about America, from his melting-pot background to his

extraordinary oratorical skills. Mr McCain is an instinctive Atlanticist who has been cultivating connections with the global elite for decades. He is a regular at the Munich security conference and an enthusiastic visitor to foreign newspapers.



Messrs Obama and McCain are also lucky in their timing. The memory of the diplomatic war over Iraq is fading. Both Germany and France have elected Atlanticist leaders. The second Bush administration has devoted a great deal of effort to rebuilding some of the bridges that the first administration blew up with such nonchalance. And if you are in the business of improving America's brand, there is no better way to start than by replacing the current president. That said, Mr Obama would clearly do a lot more to rebuff America's image than Mr McCain ever could. Some 250,000 people turned out to see him in Berlin in July; Mr McCain's earlier visit to Europe went virtually unnoticed.

Both candidates also advocate specific policies that are designed to clear some of the blemishes on America's image. They both propose a policy of cap-and-trade to deal with global warming, an issue on which American leadership has been sorely lacking for the past eight years. They both oppose the use of torture—Mr McCain with the authority of a man who was himself tortured by the Vietnamese. They both want to close Guantánamo Bay.

The second area where the two men have more in common than one might expect is the "war on terror". They have plenty of disagreements, to be sure: Mr Obama does not go as far as Mr McCain in describing it as the defining struggle of the time, and he sounds less preoccupied with state sponsors of terrorism. But whoever wins the presidency will continue to place militant Islam at the centre of his foreign policy.

Additionally, the two men also agree on other important issues that have provoked little discussion during the election campaign. One is the importance of devoting more resources to America's armed services (see article). The second is the case for reducing the world's stockpile of nuclear weapons. Mr McCain, the "warrior", describes himself as a subscriber to Ronald Reagan's dream of ridding the world of nuclear bombs.

The next president will inherit the most difficult international situation since 1968

But for all that they agree on the need for a fresh, more multilateral approach, there remain some hefty differences between the two men, even if the pressures of the campaign have narrowed them a little. Most simply put, Mr McCain remains significantly more hawkish than Mr Obama. No voter should doubt that, as president, he would be more inclined to favour a robust approach, whether that be the use of military means, or the use of tougher diplomatic ones.

This is most obviously the case over Iraq, as we explore in our next article, though it is not limited to it. In predicting American policy towards, to take another pressing instance, Iran, Americans and the world in general would be foolish not to assume that Mr McCain would be much more likely to reach for the military option than Mr Obama.

How much more jaw, jaw?

The second big difference is over diplomacy. Mr Obama hopes to use the power of negotiation to tackle some of the world's most intractable problems. During the primary he promised to hold unconditional talks with America's enemies, including the theocratic government of Iran. He promised to back talks between Israel and Syria in a bid to break Damascus's military alliance with Tehran. He also put a lot of emphasis on using diplomatic tools to solve the impasse over Israel and Palestine. Mr McCain gives the impression that he thinks talk has its limits.

Mr Obama shares his party's enthusiasm for multilateral institutions such as the United Nations. Mr McCain has made a case for creating a "league of democracies" as a counterweight to the UN: a collection of like-minded countries that would not be hampered by the UN's Faustian bargain with the Mugabes of the world.

This should not be overstated. Mr Obama has "refined" his pledge to hold unconditional talks with Iran. He has signalled his strong support for Israel. He also consults Dennis Ross, a veteran of the Bush senior

and Clinton administrations, as his key adviser on the Middle East: a man who cannot be accused of having any illusions about the magic power of diplomacy. Mr McCain believes in maintaining contact with the North Koreans, primarily through multilateral talks. He already talks much less than he did about the league of democracies. Still, it is sensible to assume that Mr Obama places more faith in “jaw, jaw” than Mr McCain does.

A third big difference is over China and Russia. The campaign has been so overshadowed by Iraq and Afghanistan that there has been little room for discussing America’s relations with these two great powers. But dealing with them will clearly be central to the next president’s foreign policy, and Russia’s assault on Georgia in August powerfully reminded the electorate that the cold war is not entirely over. Mr Obama’s first instinct was to appeal for talks: Mr McCain’s was to growl in Moscow’s direction.

Both Russia and China pose problems for America, and will go on doing so during the next four years. Russia is in the grip of an assertive nationalism that periodically takes a strongly anti-America form. The Russians are particularly irked by the expansion of NATO to their borders. China’s growing economic might is discombobulating American politics. Democrats in Congress have frequently hammered China over counterfeit goods, product safety and its exchange-rate policy. America is periodically gripped by panics about poisoned pet food, tainted toothpaste and lead-painted toys.

Mr Obama’s approach to both powers has been characterised by a belief in engagement and diplomacy (it is notable that he focused on Mexico rather than China when he criticised free trade during his primary campaign.) Mr McCain has been much more schizophrenic. He clearly shares his generation’s deep suspicion of both countries. He has suggested expelling Russia from the G8. He also suggested expanding the organisation to include India and Brazil but not China. But he has also broken with the Bush administration by vowing to work closely with Russia on nuclear disarmament and eliminating tactical nuclear weapons in Europe.

This policy schizophrenia reflects an ongoing power struggle within the McCain campaign between the realists (who believe in careful engagement) and the neoconservatives (who favour a hard line). No one can be entirely sure which side Mr McCain would incline towards, should he become president. But it is pretty clear which president would be the more confrontational (or robust, depending on how you see it) towards Russia and probably China too. This, too, should not be overstated: Mr Obama quickly had to toughen up his rhetoric on Russia back in August, and Mr McCain’s presidential bite would surely be less fierce than his candidate’s bark. But a McCain presidency would be the more prickly.

... Next article

Iraq and Afghanistan

Which war?

Oct 2nd 2008
From The Economist print edition

The candidates still have different views on the wars they will inherit, and on what to do with the armed forces

Illustration by Sarah Hanson

SO WHICH war is more important: Iraq or Afghanistan? Iraq has improved markedly, thanks in part to last year's surge of forces, while Afghanistan has worsened. Barack Obama says it is time to switch priorities: leave Iraq and focus on Afghanistan. For John McCain, "victory" in Iraq is essential.

Iraq is smaller than Afghanistan in terms of both size and population (and it is much richer too). Yet Iraq receives the lion's share of American resources. America has spent about $525 billion fighting in Iraq compared with $140 billion in Afghanistan. With the end of the surge, there are still 15 American combat brigades in Iraq and less than three in Afghanistan. Even counting the contributions of NATO allies (of mixed military worth), there is no doubt that Afghanistan is neglected.

True, the insurgency has been more intense in Iraq. More than 4,000 American soldiers have died there, compared with fewer than 600 in Afghanistan. But the equation is changing: since May more Americans have died in Afghanistan than in Iraq.

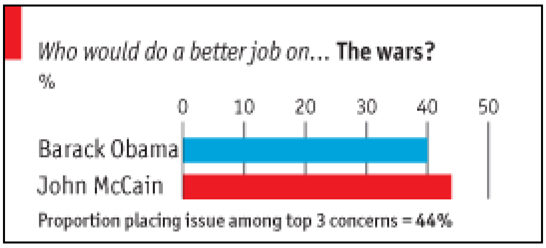
If Iraq keeps getting better, the choice for American voters may be less stark than the candidates say. The Bush administration is slowly drawing down forces from Iraq to free up troops for Afghanistan. On September 9th, it announced that a marine battalion destined for Iraq would be diverted to Afghanistan in November, to be followed by an army brigade in January.

The political context is changing too. The Iraqi prime minister, Nuri al-Maliki, has adopted a more nationalist posture. He wants a timetable that would see an American withdrawal by the end of 2011 to be part of any agreement on the status of American forces in Iraq after the current United Nations mandate expires in December. George Bush, hitherto opposed to any deadline, agrees there should be a "general time horizon" for handing over security responsibility to Iraq.

The main questions of the debate are now: can Iraq be fixed, and what happens if it takes a turn for the

worse? Mr McCain says that premature departure would invite failure, but says little about how to create a lasting government. How will some 100,000 “Sons of Iraq”, Sunni militiamen hired by America to fight al-Qaeda, be absorbed by a Shia-dominated government?

For Mr Obama only the certainty of an American withdrawal can force Iraqis to compromise in their sectarian conflict. He wants to complete a “responsible” withdrawal within 16 months of taking office, that is, by mid-2010, leaving a residual force (of unspecified size) to hunt al-Qaeda, protect the American embassy and train the Iraqi army. What if the country descends into civil war? That will no longer be America’s business, he suggests; only a genocide would prompt him to intervene again.



How many more boots?

Apart from the uncertainties of Iraq, there are questions about how much strain America’s forces can take. At the height of the surge in Iraq, soldiers were serving 15 months in war zones, with barely a year at home to recover. They still serve 12 months on and 12 off.

The army wants units to get 24 months at home between tours, but it does not have enough troops for that, given its current commitments, let alone other possible crises. Nobody knows when American soldiers, all volunteers, will decide they have had enough. Already there are worries about the quality of recruits, the retention of junior officers and stress.

For now, Mr McCain is willing to strain the army. He not only wants to stay on in Iraq, but wants to send more troops to Afghanistan than Mr Obama (three brigades to Mr Obama’s two). In the long term, though, his answer is greatly to expand the army. Mr Obama supports plans for the army and marine corps to grow from about 650,000 to 750,000; Mr McCain wants to add another 150,000 on top of that.

What if there is civil war? That will no longer be America’s business, suggests Mr Obama

Brigades do not come cheap, though. America is already spending more on defence in real terms than at any time since the second world war (though as a share of GDP, defence spending is almost at an historic low). The Pentagon faces a future shortfall of about 10%, and nobody expects big budget increases. Mr Obama talks of saving some money by scaling back spending on missile defence: conservatives hate that thought. Even so, more troops will probably have to mean fewer new ships and planes. So the new president will not just have to balance the wars in Iraq and Afghanistan, but also today’s wars with the potential conflicts of tomorrow.

... Next article

Health care

Running for cover

Oct 2nd 2008
From The Economist print edition

Fixing America's troubled health system requires taming the twin demons of cost and coverage. Which to tackle first?

Illustration by Sarah Hanson

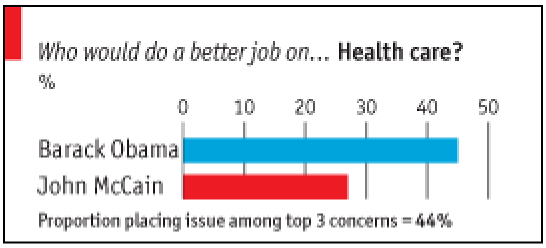
AMERICA offers the best health care in the world. If you are lucky enough to have proper insurance and be admitted to the Mayo Clinic, the UCLA Medical Centre or Johns Hopkins, you will enjoy outstanding treatment. Unfortunately, as the tens of millions of uninsured and underinsured have discovered, America offers some of the most unreliable, costliest and least equitable health care in the world too.

Two problems above all others have preoccupied those courageous enough to try to reform the $2.5 trillion colossus that is America's health-care system. The first is expense. Costs in this sector have been soaring for decades, and in recent years have consistently climbed by 2.5 annual percentage points more than the growth rate for economic output. If these trends continue, the Congressional Budget Office estimates that Medicare and Medicaid (the government's health schemes for the elderly and the indigent) will soar to 20% of GDP by 2050—more than the entire federal budget.

The second big headache is coverage. Unlike other big industrialised countries, America does not have a health system (whether government run, as in Britain and Canada, or a public-private hybrid, as in Switzerland and France) that guarantees health cover to everyone. Around 46m Americans are uninsured, a figure that has risen from about 40m back in 1994.

This does not mean these unfortunates receive no health care at all, of course. If such people suddenly have an accident or a heart attack, they still turn up at hospitals, which are required by law to treat them. But such emergency care is often extremely expensive. Lack of insurance also discourages prudent investments in prevention.

So the uninsured problem ends by driving up overall costs too. That explains why reforming the system will require addressing both cost and coverage together. However, that is quite a mouthful to chew, and politicians have generally chosen one or the other to focus on as the first target for reform.



The Clinton administration first tried to promote universal coverage ("HillaryCare") and, when that failed, attempted to slash costs through the "managed care" movement, which was hated for restricting patients' choices. George Bush's modest attempts to control costs, by means of health savings accounts, have borne little fruit. And paradoxically, by bowing in 2006 to a demand from the elderly for subsidised prescription drugs at a cost of perhaps $500 billion or more over ten years, he and the Republican Congress of the time almost certainly fuelled another round of nasty health-cost inflation.

Coverage or cost?

Given this history, it is understandable that Barack Obama and John McCain have put forward plans that, although more ambitious than Mr Bush's efforts, can hardly be called sweeping. Both candidates and their advisers insist piously that their particular proposals tackle both cost and coverage. Not so.

Look closely and it becomes clear that the two men have, in fact, made a clear choice to go after one of the two goals with more gusto: Mr Obama's plan focuses on coverage, while Mr McCain aims at cost. What is more, there is another clear distinction between the two candidates' plans. The Obama team acknowledges that his plan for coverage will be costly, and says he intends to pay for it in part from the government's coffers. In contrast, Mr McCain's advisers insist that his plan will be revenue-neutral over the long haul, and will therefore require no new government money.

In some ways, Mr Obama's decision to tackle the coverage issue is not surprising. In addition to the legions of uninsured, even those with corporate insurance now fear their firms will water down or scrap their coverage. Massachusetts has been pioneering reforms that promise universal coverage, and the pledge was a key plank in Hillary Clinton's failed primary campaign.

Mr Obama aims to expand coverage through a mix of new regulations, policy reforms and subsidies. Under his plan, insurers would no longer have the right to reject anyone as too ill or too costly. He would create a "National Health Insurance Marketplace" (akin to the regulated "connector" set up in Massachusetts) where individuals and firms could purchase either private insurance plans or public alternatives modelled on Medicare. In future all but the smallest of corporations would be required to offer insurance—or pay a stiff fine. Mr Obama would offer families tax credits for the purchase of either public or private insurance.

Will it work? Mrs Clinton insisted it would not. Her main objection was that this plan did not contain a key feature shared by her plan and the Massachusetts reforms: an individual mandate, or legal requirement, to purchase cover. Under Mr Obama's plan, the only personal mandate is that parents must buy insurance for their children. Fans of mandates argue that without compulsion, reform efforts will be upended by the problem of adverse selection. Young and healthy people opt not to buy coverage, leaving a sicker and so costlier risk pool.

Mr Obama's pragmatic, and politically clever, retort is that it is unreasonable to require individuals to purchase something whose cost cannot be known with certainty in advance. Therefore, he insists, he will take measures that will both expand the insurance market and reduce the overall cost of coverage by (he claims) some $2,500 per typical family over time. That will make it so attractive to individuals to buy insurance, say his advisers, that 98% of people will do so.

Reforming the system will require addressing both cost and coverage together

This points to a few question-marks about Mr Obama's plan. One is that nobody knows how big the problem of adverse selection will be in a system without mandates. But supporting his argument for pragmatism is the trouble that Massachusetts is finding in implementing its ambitious mandate. Although hefty subsidies are provided for the poorest and insurers have been pressured to offer cheaper plans, far more residents than expected have found insurance unaffordable and have therefore been granted waivers. One architect of the state's plan says that unless costs are reined in rapidly, it "will fall apart in a couple of years".

The second unknown concerns how Mr Obama will pay for his plan, which his advisers reckon may cost $50-65 billion a year. He says he will use the $70 billion or so a year freed up by rolling back Mr Bush's income-tax cuts for the wealthiest, but critics complain that those tax cuts were supposed to expire soon anyway. If his promised cost savings do not materialise, the plan will become unsustainable.

As with Mr McCain's ideas on cost savings (below), it is hard to estimate how much money Mr Obama's policy fixes (such as boosting prevention) will save. Experts at the Tax Policy Centre (TPC), an independent think-tank based in Washington, DC, ignore such claimed savings completely in doing their sums. The TPC calculates the McCain plan will cost about $1.3 trillion over ten years, while the Obama one will cost about $1.6 trillion. Any cost savings will reduce those sums.

Penny-pinching

At the heart of Mr McCain's strategy is the elimination of the tax advantage enjoyed by employer-provided health insurance over the sort obtained by individuals directly with an insurer. This tax break has been a politically popular feature of America's corporate landscape since the second world war.

But most economists hate this giveaway, which costs the Treasury over $200 billion a year, arguing that it distorts the market in two ways. It biases the market against individual plans, which receive no such tax break. And it ties employees to firms, thus diminishing labour market flexibility.

Mr McCain's reforms would replace that corporate subsidy with a refundable tax credit, worth up to $5,000 per family, for people to buy their own insurance from anyone they like. He would allow them to purchase insurance across state lines and through such organisations as churches. Unlike Mr Obama, he will not force insurers to accept everyone, but he will offer federal funding for state-run "high-risk pools" which (he claims) will defray the cost of covering the sickest.

Will it work? Mr McCain certainly deserves applause for proposing an end to the employer subsidy. That is worth doing, but it could make it less attractive for firms to offer health insurance. Mr McCain insists that very few big firms will actually drop coverage. But the boffins at the TPC are unconvinced. They calculate that Mr Obama's plan will reduce the number of uninsured quickly (by about 18m in 2009, and by 34m in 2018), but that Mr McCain's plan would lower the number by only 1m-5m by 2013.

Mr McCain's advisers reject that analysis, arguing that the tax credit given to individuals to buy insurance on their own will allow millions of Americans to get coverage, far offsetting any decline in corporate cover. But given that a typical health plan for a family costs $12,000 or so, it is unclear how many of the working poor will be motivated by a $5,000 refundable credit. The high-risk pools proposed by Mr McCain also raise doubts. States that have experimented with this timid approach to reform have mostly failed.

In the end, both plans have their virtues. With Mr Obama's, the big unknown is how much it will really cost to reach near-universal coverage, while the uncertainty about Mr McCain's strategy to tackle costs is whether it will do much to expand coverage. Given the growing ranks of the underinsured and an increasingly common view that this is a scandal for a country as rich as America—never mind the 46m with no health insurance at all—voters may prefer the plan that promises to cover everyone quickly, and let future voters worry about the cost.

... Next article

Immigration

The lurking monster

Oct 2nd 2008
From The Economist print edition

Both candidates hope immigration will go away as a political issue. Both are likely to be disappointed

Illustration by Sarah Hanson

TO ALMOST everyone's relief, immigration is no longer the urgent issue that it was last year and in 2006. Unless they are in front of Hispanic crowds, neither Barack Obama nor John McCain says much about the subject. Polls show that people care much more about the economy and national security.

But don't be fooled. Immigration has not disappeared as a political issue. It is merely hiding in the swamp. Apart from moral values such as abortion, no topic cuts so deeply into Americans' sense of who they are as a people. And no subject is more difficult or dangerous for politicians to handle. Immigration is to modern politics what violent crime was in the 1980s: an apparently marginal issue that can swiftly overwhelm a campaign.

Americans' attitudes to immigration often seem erratic, even contradictory. Liberals and conservatives alike assert that America is a land of immigrants, as though this ends any argument over the matter. Only a tiny fringe wants to stop it altogether, and those who believe there is too much immigration are outnumbered by those who think the flow is about right or (a rarer position) too slow. Europeans, who often complain about Americans' insularity and conservatism, are much less welcoming. Yet Americans feel a mixture of despair and contempt for the immigration system and, frequently, for immigrants themselves.

A series of polls carried out by Gallup between 2001 and 2007 reveal an almost bipolar attitude to the issue. By large margins whites, blacks and Hispanics agreed that immigration is broadly a good thing. Yet by similar, and in some cases even bigger margins, they believe immigration has harmed, or at least failed to improve, the nation's economy, job market and social values. They also held them responsible for rising crime. Only the quality of food, music and the arts were thought to have improved as a result of immigration. And restaurants top few people's lists of priorities. Why the contradiction?

One explanation is that Americans are drawing a distinction between principle and practice—or what they assume to be practice. The popular image of the immigrant is a Mexican man who arrived in the country hidden in the back of a truck. There is no point in telling people that most immigrants are neither illegal nor Mexican. This is the kind they see loitering outside hardware stores in search of work, and on the evening news. The illegal Mexican offends for several reasons. He has flouted the nation's laws and imported a foreign language and customs. These days, thanks largely to tighter border security, he is unlikely to go home again.

This figure has hardened attitudes to immigrants but not, yet, to immigration. The principle that a flow of newcomers is what gives America its special character remains strong. Immigration is a litmus test of decency and optimism about the future of the country. Most people want to pass it.

American's attitudes to immigration often

seem erratic, even contradictory

This helps to explain an odd feature of the politics of immigration: candidates are often punished for saying exactly what voters say they want them to say. A politician who bangs on about how illegal immigrants are damaging the country's economy and committing crimes tends to sound at best like a pessimist, at worst like a bigot. Americans want neither for a president, or even a representative. In the 2006 mid-terms several Republican congressmen from border areas, noting the fury of their constituents, ran harsh anti-immigration campaigns. To their puzzlement, they were swept from office.

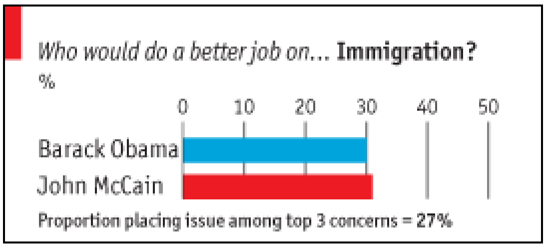
A similar fate befell Tom Tancredo, a one-note candidate for the presidency who failed to make it even as far as the Iowa caucuses. One reason for this, as he pointed out, was that other Republican candidates had moved to "out-Tancredo" him by calling for an expanded border fence and tough enforcement of immigration laws. This was to be expected from an opportunist like Mitt Romney. It was rather more of a surprise when John McCain also lurched rightward on the issue. More surprising still, Mr McCain has not yet moved back to his former position.

Blowing in the wind

Until recently Mr McCain's record on immigration was so liberal that the National Council of La Raza has twice given him an award for his political work. He has long fought for "comprehensive" immigration reform—code for any change that would provide a route to citizenship for illegals. This effort culminated in the Immigration Reform Act of 2007, which would have allowed virtually all illegal immigrants to remain in the country on a special "Z" visa. After paying a fine and back taxes, they could apply for permanent residency and, eventually, citizenship.

Although the bill also contained money for border security and was supported by George Bush, many of Mr McCain's fellow Republicans turned against a measure that opponents had successfully labelled an "amnesty". It died in June, 2007 following an extraordinary barrage of phone calls by anti-immigration groups. The episode revealed one of the few clear lessons of the politics of immigration: the people who feel strongly about it often feel very strongly indeed.

When Mr McCain talks about the issue these days he sounds chastened. The failure of immigration reform taught him a lesson, he says—that Americans will tolerate a move to legalise illegal immigrants only if they are assured the border has been fixed. The senator plans to achieve that through a combination of walls and electronic surveillance. Only when the governors of the border states say the border is secure, will he do something about America's 12m illegal immigrants.



Unless the governors are prepared to overlook quite a lot, it is unlikely that a President McCain would ever get around to the second stage of his plan. America's border with Mexico is 2,000 miles (3,200km) long. It runs through cities, mountains, rivers, desert and Indian reservations. It is possible to slash crossings in a particular area by flooding it with guardsmen or building walls. It is not, however, remotely possible to seal the whole thing. Britain, an island nation with a more centralised government and a far tighter surveillance web, contains illegal immigrants from as far away as China.

Mr McCain's move rightward on the immigration issue has given Mr Obama considerable room to manoeuvre. He has nonetheless held a fairly orthodox liberal line on illegal immigration. He supports giving illegals a route to citizenship and promises to make it a priority during his first year in office. During the primaries he expressed support for Eliot Spitzer, then the governor of New York, who was trying to grant driving licences to illegals. This is a totemic issue for liberal Hispanics, but unpopular with many others.

Unwelcome guests

Like many politicians with roots in troubled cities, Mr Obama is much less keen on increasing the number of guest workers. This was also part of the immigration bill, but, thanks in part to Senator Obama, it was severely pruned even before the measure died. He backed a measure cutting the number of guest workers from 400,000 to 200,000. He introduced another measure that would have banned companies from employing guest workers in areas of high unemployment and required them to pay prevailing wages. He also supported a move to end the programme after five years. Since the programme was

about the only thing many Republicans liked about the immigration bill, this ruined its chances.

Just as a President McCain would have to soften his stance on border security in order to pass an immigration bill, so a President Obama would have to tone down his anti-business rhetoric. Without support from businesspeople it will be extremely difficult to persuade Republican politicians to go along with reform. It is especially important to get farmers onside. They often depend on illegal labour and can be a heavy counterweight to nativist sentiments in rural areas. They also have powerful lobbyists in Washington.

The differences between the candidates' positions are less striking than the contrast in how they speak about illegal immigration. Mr Obama talks of giving hope to families living in fear of raids and deportation. Mr McCain goes no further than a general expression of sympathy for "God's children". But he feels the pain of ordinary Americans who fret that they are being overrun.

Mr McCain's stance on immigration is closer to that of the average American. Yet Mr Obama appears to have the edge. He can point out, fairly, that his opponent has flip-flopped on the issue. His liberal stance impresses Latinos, who remain angry at the Republican party for caving in to nativist pressure last year. They account for more than a tenth of the electorate in Arizona, California, Colorado, Florida, Nevada, New Mexico, New York and Texas. They may decide extremely close races even in states where they are thin on the ground, like Wisconsin.

Immigration is also one of the few areas where Mr Obama's race helps him. Blacks are more threatened by competition from immigrants, particularly illegal ones. Many fights in schools and prisons are between blacks and Latinos. As a result, a black politician who supports immigration reform comes across as particularly brave.

Yet the issue can turn, and quickly. An effective ad campaign could dredge up submerged fears of immigrants and push the issue close to the top of people's concerns. As the economy sours, Americans will probably become less tolerant of those who compete for their jobs. An illegal immigrant could commit a horrific, widely-publicised crime. Working-class whites are already wary of Mr Obama. If immigration suddenly rises from the swamp, they may well run straight into the arms of the newly tough Mr McCain.

... Next article

Energy and the environment

Greener than thou

Oct 2nd 2008
From The Economist print edition

Both candidates are much greener than the president they are vying to replace. But there are still big differences in their policies

Illustration by Sarah Hanson

BACK in July, in an early exchange of hostile TV commercials, the two candidates blasted away at one another's energy policies. The Republican National Committee told viewers in battleground states that Barack Obama "says no to lower gas taxes. No to nuclear. No to more production. No new solutions." The Obama campaign, naturally, disagreed. "On gas prices, John McCain's part of the problem," it retorted.

The subject of the scuffle was no coincidence. More than any other issue save the general health of the economy, it is the price of petrol (gasoline) that is galvanising voters. The average price at the pump, though falling recently, is up more than a quarter on its level a year ago. As motorists' wails have grown louder, both camps have scrambled to come up with reassuring proposals.

The problem is that there is little anyone can do to reduce the price of oil in the short term. And both candidates also want America to do its bit to tackle global warming by cutting its emissions of greenhouse gases, which is hard to do without increasing, rather than reducing, the cost of fuel. The result is incoherent policies: long-term plans aimed at conserving energy and reducing emissions, undermined by short-term sops to drivers.

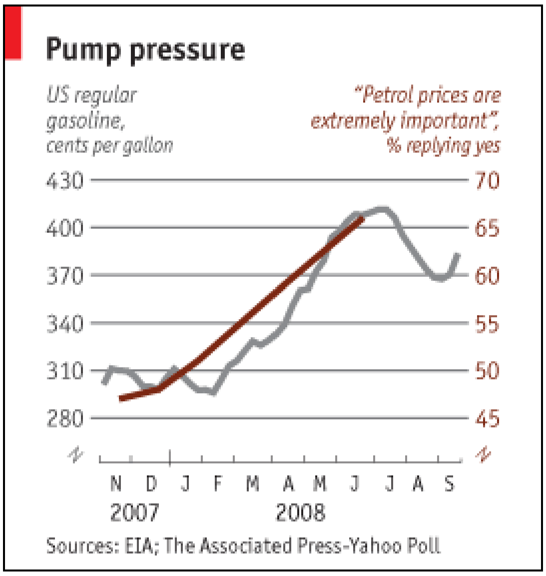
For the most part the candidates share similar views about energy and the environment. To the extent that they differ, it is over how far and by what means to advance this agenda. Mr McCain, in true Republican fashion, is less zealous in his environmentalism and more forgiving of big business, whereas Mr Obama, in keeping with Democratic orthodoxy, envisages stiffer regulation for business and a bigger role for government.

Neither campaign, of course, wants to admit its impotence at the pump. Both propose a slate of policies that they claim will lower prices. Mr McCain, most notably, has suggested suspending America's relatively paltry tax on fuel to make life easier for motorists. Mr Obama, meanwhile, wants to raise taxes on oil producers, and give some of the proceeds to help those hardest hit by the rise in energy prices.

Oil or nothing

Both these ideas may sound good to audiences on the campaign trail, but are likely to prove counterproductive in practice. Reducing the price of petrol without increasing domestic supply, as Mr McCain would do, would only encourage people to drive more and discourage conservation. That increase in demand, in turn, is likely to push prices higher once more. The result would be similar petrol prices, but with more of the money going to the nasty oil-fuelled regimes Mr McCain claims to oppose, and less to Uncle Sam.

Mr Obama's windfall tax is equally ill-conceived. Higher taxes on energy firms will only raise the cost of producing oil in America, and so discourage investment. That, in time, would lead to lower domestic output, higher prices and greater reliance on those foreign petro-dictators, who are not Mr Obama's favourites either.



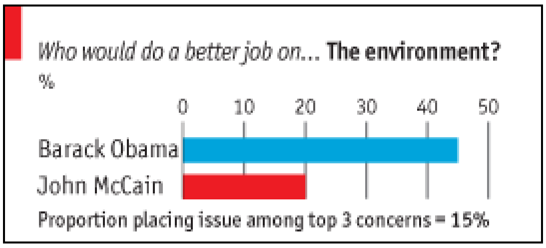
To be fair, the candidates also have some reasonable policies on fuel prices, though these will be slow to have an impact and are therefore harder to sell to voters. To boost domestic oil supply, Mr McCain wants to lift the long-standing ban on drilling off the Atlantic and Pacific coasts (although, unlike Sarah Palin, he would keep the Arctic National Wildlife Refuge off-limits).

It is hard to understand why Mr Obama opposes this idea, beyond a traditional Democratic distaste for helping out big oil firms—indeed, he has said he might drop his objections in an effort to push a bipartisan legislative package on energy. This was wise, since "Drill, baby, drill!" has become an effective Republican slogan. Plenty of countries, after all, manage to produce oil offshore without devastating environmental consequences, as America itself does in the Gulf of Mexico.

On the other hand, Mr McCain seems to reject Mr Obama's plan to raise fuel-economy standards for vehicles out of traditional Republican sympathy for big business. Both candidates have crossed Detroit's carmakers over the issue in the past. Last year Congress approved the first big tightening of standards in decades. But Mr McCain says he wants to concentrate on enforcing existing rules, rather than tightening them further.

These ideological biases are apparent even in areas where the two candidates agree. Both, for example, are keen to encourage the use of biofuels and batteries to reduce America's reliance on imported oil and cut greenhouse-gas emissions. But Mr Obama tends to see bureaucratic mandates as the way to do that, whereas Mr McCain is much keener to harness the market. (Neither will countenance a carbon tax, the best way to do it.)

The Democrat envisages four overlapping sets of regulations to promote ethanol: a renewable-fuel standard, a low-carbon-fuel standard, incentives for producing cellulosic ethanol (from trees and grasses, rather than from corn or sugar) and incentives for locally owned ethanol distilleries.



Mr McCain, by contrast, shocked Iowans by refusing to endorse subsidies for ethanol before the state's pivotal caucus, which he duly lost. With equal courage, he opposes the tariff on imported ethanol, which is designed to prevent foreigners from taking advantage of the subsidies. He argues, rightly, that these sops to farmers simply distort the market for biofuels, and so prevent the cheapest and greenest options from prevailing.

Mr McCain does, however, have a fondness for tax credits. He suggests one to encourage cleaner cars, another to encourage spending on research, and a third to promote renewable power. For the most part, these are broadly defined incentives that would allow markets rather than bureaucrats to pick the most promising technologies. Indeed, unlike Mr Obama, he wants to replace the current patchwork of credits for different forms of renewable power with a single, simpler system.

But Mr McCain is not consistent. He has singled out nuclear and clean coal as two technologies that are worthy of special attention. He says America needs at least 45 new nuclear plants by 2030, and favours subsidies for nuclear power. He also wants to spend $2 billion a year helping utilities figure out how to filter carbon dioxide out in their chimneys and bury, or sequester, it underground. He has also proposed a $300m prize for anyone who comes up with a battery that is small, cheap and powerful enough to propel electric cars into the mainstream.

Ideological biases are apparent even in areas where the two candidates agree

Still, all that pales next to Mr Obama's extravagant agenda. He plans to spend a whopping $150 billion

promoting clean energy. He wants the government to double spending on scientific research, to retrain workers to take up “green-collar jobs”, to help overhaul grubby industries and to set up a venture-capital fund to bring new technology to market. He wants both the federal government and the states to invest in an expensive upgrade of the electricity grid, the better to bring renewable energy from windy plains and sunny deserts to cities. A loyal Democrat, he does not back building any additional nuclear power stations.

Mr Obama is also keen to steer more funds towards public transport. He seems as keen to meddle in the details of the energy business as Mr McCain seems reluctant. He has even set a date—2014—for phasing out incandescent light bulbs, which are less efficient than the compact fluorescent sort.

Green and greener

At first glance, the candidates seem in complete accord on the subject of climate change. They both advocate a cap-and-trade scheme, whereby the government sets an overall limit on carbon-dioxide emissions, and then issues a corresponding number of tradable permits to pollute. The intention is to ratchet down the permitted level of emissions each year, while giving industry as much flexibility as possible in meeting the target.

By championing cap-and-trade, Mr McCain is already out of step with most Republicans, many of whom are sceptical about global warming and reluctant to take bold steps to counter it. But on the finer points of climate-change policy, the candidates reflect the predilections of their parties. Mr McCain’s scheme, perhaps unsurprisingly, is less rigorous: he wants to cut emissions by 60% of their 1990 levels by 2050, compared with Mr Obama’s 80%. He also plans to go easier on dirty industries: to begin with, he would distribute most of the permits to pollute free of charge, whereas Mr Obama intends to auction them all from the start.

Ultimately these nuances are likely to prove relatively inconsequential. Messrs McCain and Obama both seem keener than most on cutting America’s emissions and encouraging other countries to do the same. But either would struggle to prevent their plans from being watered down by a reluctant Congress. Either would face enormous problems persuading the Senate to ratify a treaty on climate change, which it has to do by a two-thirds majority. America’s debate about energy and climate change is far too contentious, and too new, to be resolved in a single election. It will surely be the subject of attack ads for decades to come.

... Next article

Economist.com OPINION

Education

Still at risk

Oct 2nd 2008
From The Economist print edition

Can the candidates fix America's decidedly mediocre schools?

Illustration by Sarah Hanson

"OUR nation is at risk. Our once unchallenged pre-eminence in commerce, industry, science and technological innovation is being overtaken by competitors throughout the world." So reported an education commission in 1983. That report was a turning point for American schools, helping spur a wave of reform. But 25 years later the state of American education is in a muddle.

In some ways its public schools have improved. America's nine-year-olds scored 22 points higher on a national maths test in 2004 than they had in 1982. But in many areas America still languishes, as described in a recent report by Ed in '08, an advocacy group. The percentage of 17-year-olds with basic reading skills has dropped, from 80% in 1992, when the current test was introduced, to 73% in 2005. On the international stage, American students are doodling while others scribble ahead. The Organisation for Economic Co-operation and Development has a glum statistic: in the most recent ranking of 15-year-olds' skill in maths, America ranked 25th out of 30. Though America's universities remain pre-eminent in the world, they have grown increasingly unaffordable. Barack Obama notes that between 2001 and 2010, 2m qualified students will not go to university because they cannot afford it.

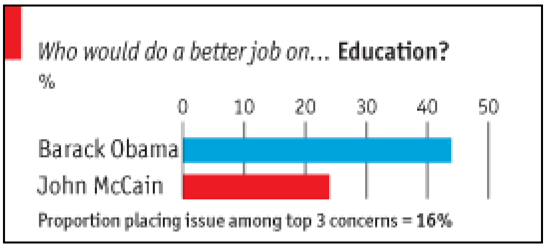
Efforts to move America forward have proceeded fitfully. A federal bill, No Child Left Behind (NCLB) was passed with broad support in 2002, the culmination of a long push to set high standards and hold schools accountable for meeting them. It requires states to test students on maths and reading; science is being added. Schools that do not progress towards meeting state standards face financial sanctions.

But the law is hotly debated. George Miller, a Democratic congressman, calls NCLB "the most negative brand in America"—and he was one of the law's architects. Teachers' unions utter no four-letter word with more vitriol than NCLB. They say the law forces "teaching to the test", that the sanctions are too strong and the carrots too small. Even those who still support the law find problems with it. NCLB, for example, does not chart a student's progress.

Some states have set their standards very low. Some 90% of Mississippi's fourth-graders were labelled "proficient" or better on a state reading test in 2007; only 22% were so described after a national test.

Unsurprisingly, advocates from all corners are trying to make education a main campaign issue. Ed in '08 points out that many of the proposals from "A Nation at Risk" have been ignored: standards remain weak, few districts pay teachers by

results and calls for a longer school year have gone unheeded. But despite a budget of $60m, Ed in ’08’s campaign has had little impact.



Mr Obama is at least taking the problem seriously. His plans run the gamut, from grants for preschool programmes to a $4,000 tax credit for university fees. He is vague about NCLB, but has resisted calls to throw out the law. He suggests improving it through more sophisticated tests, measuring students’ progress over time and giving schools more resources. In September he announced new plans to double federal funding for independent or “charter” schools. A separate “innovative schools fund” would help districts to create a portfolio of successful school types, including charters.

Perhaps most interesting are his plans for teachers. He would give extra money to districts that work with their unions to form “career ladders”. These could include pay increases for a list of achievements, from teaching in hard-to-staff schools to lifting students’ performance. But a good scheme on paper may be diluted in practice. Negotiations over pay are messy at best.

For his part, Mr McCain offers promising opinions but few details. He supports NCLB but has said little about how to strengthen its main tenets. He supports charter schools (like Mr Obama) and voucher programmes (unlike Mr Obama, who is dead-set against them), but has said little about how he might expand them. His boldest ideas centre around using federal money to let parents choose tutors and principals reward good teachers.

In the debate over how a president might help America’s schools, a main obstacle is that, traditionally, it has not been his job to help them much at all. The national government provides less than 10% of total spending on schools. Indeed, states and cities continue to be the boldest innovators. Chicago is opening dozens of new schools, including charter schools, in its poorest areas. Cities such as Denver and New York now have schemes to reward teachers for their skill. The results there are mildly encouraging.

The two candidates offer different plans for how they might push these reforms along. Both, however, have largely overlooked the most obvious role. At the very least, the next president could help to create a better benchmark for student achievement. As Mississippi proves all too well, a state standard can be an elastic ruler.

... Next article

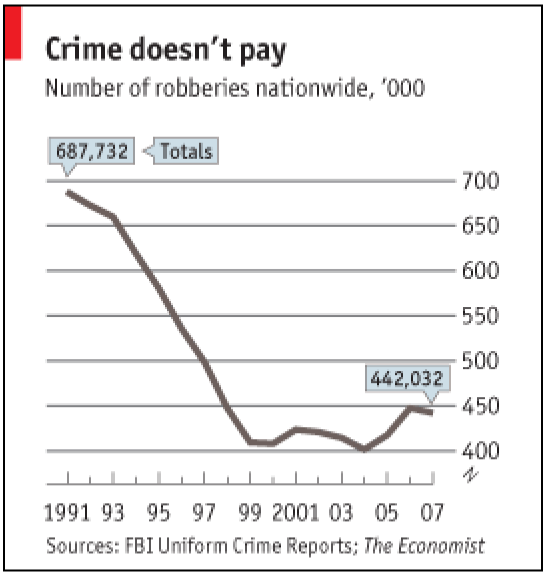
Crime

Hanging fire

Oct 2nd 2008
From The Economist print edition

Neither candidate has talked much about crime. But what they have said is highly revealing

IN 1988 Michael Dukakis, the Democratic presidential nominee, was asked whether he would support the death penalty for somebody who had raped and murdered his wife. No, he said calmly—he had always opposed capital punishment. His poll numbers plunged, and a few weeks later he carried just ten states. The Democrats took a lesson from this: don't talk about crime and the death penalty, or, if you do, talk tough.



Until recently it was easy to say little. Three years after Mr Dukakis's comments crime began to tumble. The number of robberies fell from 688,000 in 1991 to just 401,000 in 2004 even as the population increased (see chart). The only thing policemen, mayors and presidents were expected to say was how splendid this was. Apart from a few liberals, who fretted about the expanding prison population, most believed that the problem was solved.

Then something alarming happened. Between 2004 and 2006 murders went up by 5% and robberies by 11%. The increase was driven by some terrifying surges in medium-sized cities. Between 2005 and 2006 murders soared by 56% in Oakland, California; the next year Newark, New Jersey, counted as many dead bodies as it had in the early 1990s. The tide soon ebbed in both cities, but complacency had been shaken. Now two other threats loom, in the form of an economic downturn and a wave of ex-convicts due to be released from prisons. Statistically and politically, crime is back.

Illustration by Sarah Hanson

Law and order is one area in which John McCain's reputation as a maverick is misplaced. His views on crime are thoroughly orthodox for a Republican. He favours long sentences for internet predators, gang members and repeat violent offenders. He wants child molesters tracked until they die. He is against "overreaching" judges who stop incriminating evidence from being heard in court. He is strongly against judges who strike down laws like Louisiana's death penalty for child rapists. He is most opposed of all to those who stop law-abiding Americans carrying guns.

Barack Obama has largely kept to the post-Dukakis doctrine. He has been much quieter on the subject than his opponent, and when he speaks it is usually to take a populist position. Like Mr McCain, he publicly disagreed with the Supreme Court's ruling on the death penalty in Louisiana. He also praised the court's decision to strike down a handgun ban in Washington, DC.

Beyond the sound bites, the candidates are far apart. Mr McCain sees crime as a disease and the criminal-justice system as the cure. He thinks the government should tip the fight to the good guys by toughening sentences and building more prisons. Mr Obama thinks the justice system itself is flawed. He complains about the large number of black men in prison, together with one of the reasons for it: the disparity in sentencing for possession of crack and powder cocaine. He hints at a review of mandatory minimum sentences.

He comes up with different solutions, too. Oddly, Mr Obama is much more likely to inveigh against broken families. He links the epidemic of single parenthood among blacks to the high rate of black criminality (this provoked Jesse Jackson to whisper that he wanted to “cut his nuts off”). Like a liberal 1960s sociologist, he sees crime as a product of society. Like a conservative, he blames it on the breakdown of traditional values, not on inequality.

He does, however, think the federal government can provide one thing: cash. Mr Obama says he will restore funding to Bill Clinton’s “COPS” programme, which aimed to put 100,000 extra officers on the streets. He bashes his opponent for voting against the measure. Although the programme’s effect on crime rates has been disputed, mayors and police chiefs are keen on it. With virtually all large and medium-sized American cities now under Democratic control, expect a lot of co-ordinated campaigning on the issue.

... Next article

Values

Endless culture war

Oct 2nd 2008
From The Economist print edition

Pastimes and preachers may matter as much as guns and butter

Illustration by Sarah Hanson

AMERICA has no shortage of serious issues to discuss. The Bush administration launched a pre-emptive war on Iraq on the basis of faulty intelligence. America has seen the most serious decline in its global image since the second world war. Its budget deficit has ballooned, while recession looms.

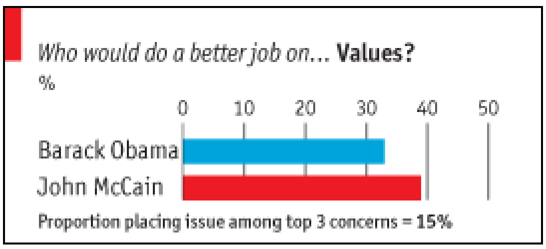
And what was America discussing in the wake of the Democratic and Republican conventions? Whether an offhand comment by Barack Obama about “lipstick on a pig” was sexist. Whether the phrase “community organiser”, used by Republicans about Mr Obama, is racist.

John McCain’s decision to choose Sarah Palin as his running-mate put the culture wars back at the heart of the election. Mrs Palin is an evangelical Christian. She opposes abortion even in cases of rape, and recently gave birth to a Down’s syndrome child. She supports banning gay marriage.

Mr McCain’s choice of Mrs Palin was greeted with derision by the media. But this derision created a reaction that is reshaping the political landscape. The Republicans struck back by releasing a swarm of ads designed to present Mr Obama as a hoity-toity liberal elitist. And Mr McCain, for the first time, briefly took the lead in the polls.

The descent of American politics into pig-wrestling has dismayed America’s best friends abroad. Both presidential candidates seemed different, at first, from the traditional culture warriors. Mr McCain made his reputation as a maverick with no time for the guardians of cultural orthodoxy on either side. During his bid for the Republican nomination in 2000 he denounced two of the most powerful Christian conservatives, Pat Robertson and Jerry Falwell, as “agents of intolerance”. Leading conservatives fought furiously against his nomination: they regarded him as squishy on abortion and downright wrong on gay marriage. They want a constitutional amendment banning gay marriage, while he thinks the decision should be left to the states.

Mr McCain has also long been visibly unhappy with the weaponry of the culture wars. He belongs to a generation of Republicans—Gerry Ford and Bob Dole were other examples—who felt that these sorts of things should be discussed in private (if at all) rather than shouted about in the public square. Mr McCain is much happier talking about the warrior virtues of courage and service than telling the world how Jesus changed his heart.



Mr Obama, for his part, is a natural mediator (or “fudger” to his critics). His way is to smooth over differences, not sharpen them. In his career-making speech to the Democratic convention in 2004 he argued that there is a “United States of America”, not “red states and blue states”. Mr Obama argued

that Democrats had made a mistake in refusing to address religious issues or court evangelical voters.

Nor should the circumstances have been propitious for a repeat of the culture wars. Americans have plenty besides heaven on their minds. And besides, the conservative side of the culture war has been in a serious funk: disillusioned with George Bush, riven by faction fights and uncertain about the future. It suffered catastrophic defeats in the 2006 mid-terms, with conservative heroes such as Rick Santorum losing his Senate seat and conservative ballot measures going down to defeat.

Both Mr Obama and Mr McCain also had good reasons for avoiding some of the most emotive issues in politics. Mr Obama, like most Democrats recently, has ducked the issue of restricting gun ownership. He does not want to alienate Democratic-leaning gun owners, particularly in the West, one of the most important swing regions in the country.

Mr McCain trod lightly on the subject of stem-cell research, because he has a more liberal position than his party base. Both candidates were reluctant to discuss gay marriage, because they realised that giving in to their party's activists (for gay marriage in the Democrats' case, for a constitutional ban on it in the Republicans') might alienate middle-of-the-road voters. Both candidates endorsed a compromise—supporting civil partnerships and allowing the marriage question to be decided by voters in the states.

The warriors resurrected

But the idea that America might escape from another round of the culture wars was always naive. They have been a fixture of politics ever since Richard Nixon raised his standard on behalf of the "silent majority" in the late 1960s. They are driven by a simple fact: many Americans are all too eager to go to war over values. Conservative evangelicals and liberal professionals not only live in different worlds, both geographically and culturally. They are hard-wired to dislike each other—conservative evangelicals to feel that the liberal professionals look down on them, and liberal professionals to regard the evangelicals as knuckle-draggers who are bent on imposing a theocracy.

Messrs McCain and Obama are also products of different times, and very different backgrounds. Mr McCain descends from a long line of warriors, lives on a ranch and was born in the 1930s. Mr Obama was born in the utterly different 1960s, a post-baby-boomer whose generation escaped the bitterness of Vietnam, who has a mixed-race background and who has spent his career in universities and big-city politics. They summon up very different emotions in their supporters, with Mr McCain's talking of "country first" and "courage", and Mr Obama's of racial and global reconciliation.

Even before the Republicans applied a match to the touchpaper, culture wars kept flaring up out of nowhere. The most dramatic explosion was ignited by Jeremiah Wright, Mr Obama's long-term pastor: a man who led the young Mr Obama to God, presided at his marriage, baptised his two daughters and provided him with the title of his bestselling memoir, "The Audacity of Hope". A YouTube video showed Mr Wright arguing that America was to blame for its chickens coming home to roost on September 11th 2001. We should not say "God bless America", the reverend averred, but "God damn America".

There are two good reasons for thinking that the culture wars have a lot of life left in them

The second flare-up was "Bittergate". Mr Obama complained to a group of well-heeled San Francisco donors that the reason some working-class voters had not warmed to him was because, in their bitterness over their economic woes, they clung to guns and religion. Mr Obama was certainly right that he found it difficult to connect with ordinary voters. He looked uneasy holding a beer. He talked about the price of arugula. He performed dismally at bowling.

Mr Obama upbraided Mr Wright in a widely-praised speech in Philadelphia on race relations and subsequently resigned from his church. But both "Bittergate" and the Wright affair underlined the fact that Mr Obama's biggest liability in the election is a cultural one: he simply does not seem like an average Joe. He has an odd name and an exotic background, and 12% of Americans believe that he is a Muslim. Hillary Clinton, his main challenger for the Democratic nomination, did strikingly better than Mr Obama among white-working-class voters.

Most important of all is that the Republicans have no choice but to turn the election into a culture war. Almost 80% of Americans think the country is on the wrong track. George Bush has an approval rating of 32%. Most people think the Iraq war was a mistake. The collapse of mighty banks like Lehman Brothers and Bear Stearns are bad news for anyone with a pension. And Democratic social policies are much more

popular than Republican ones: more than 60% of evangelicals, a highly conservative group, favour Democratic policies on health care. If the election is fought about anything except culture, then the Republicans are on difficult ground.

They are also much better at culture wars than the Democrats, who awkwardly need to appeal to both liberal professionals and blue-collar workers. Steve Schmidt, Mr McCain's bullet-headed chief campaign strategist, is a protégé of Karl Rove who relishes gouging out the eyes of his enemies. He has already produced a series of ads which even Mr Rove has criticised for going too far.

Playing for keeps

There is a more substantive reason why the culture wars remain at the heart of American politics. Most countries decide on the legality of abortion through the ballot box. America does it through the Supreme Court. This not only divides America between pro-choice absolutists (who regard even late-term and partial-birth abortion as acceptable) and pro-life absolutists (who think that abortion is wrong even in cases of incest or rape). It also means that many cast their presidential vote on the basis of who the president will nominate for the Supreme Court.

The court currently has a soft conservative majority, with Anthony Kennedy acting as the swing vote. Mr Bush appointed two conservatives to the court, John Roberts and Samuel Alito, who are likely to be around for decades. The next president is likely to appoint at least one new justice: John Paul Stevens, a liberal, is 88, and Ruth Bader Ginsburg, another liberal, is 75. If Mr McCain wins the White House, he could solidify the conservative majority for a generation; if Mr Obama wins, he will at least be able to hold the present wavering line. This calculation, inevitably, is in the forefront of the thinking of some of the most committed activists in the country.

Mr McCain and Mr Obama once sold themselves as politicians who could overcome the divisive politics of the likes of George Bush and Hillary Clinton. The sad truth is that they are now fighting a classic culture war that will leave the country more divided over "values" than ever.

... Next article

Conclusion

The three elections

Oct 2nd 2008
From The Economist print edition

Voters must decide whether the economy, security or “values” matter most to them

PUT all this together and what do you get? Is this, as cheerleaders on both sides claim, the most consequential election in a generation, or will little change? Will Barack Obama, if elected, soon find that Washington “boils all the hope out of him”? Will John McCain find that once in the Oval Office the maverick becomes a mouse?

The first answer is that, no matter which contender wins the prize, America will tread a very different path from the gloomy one down which George Bush has taken it. Both Mr McCain and Mr Obama set greater store by multilateral organisations and the value of partnership than Mr Bush has done. Either would close the prison at Guantánamo Bay, that standing insult to civilised global values, and either would sign America up for some form of climate-control agreement. Either would find himself travelling a good deal more than the embattled Mr Bush has done, not least because they will be assured of a much more sympathetic welcome—though there is no doubt that Mr Obama would get the warmer one.

At home, either presidency would differ markedly from Mr Bush’s dismal last few years during which, all political capital squandered, he has been unable to get anything of consequence done. If Mr McCain is in charge, his record of bipartisan outreach will stand him in good stead; Mr Obama will be able to rely on solid majorities in Congress. So either man seems better equipped than Mr Bush was to break through the partisan logjam that bedevils America’s politics.

The second conclusion is that it really does matter who is chosen. Sharp contrasts distinguish the two men both in philosophy and in policy. These are starkest in the domestic arena. Mr McCain is at heart a classical economic liberal who favours big tax cuts, a simpler tax code, minimal government intervention and enthusiastic use of the veto pen. Mr Obama has a fondness for complicated subsidies and targeted tax breaks, and an underlying belief in the power of government to improve things. His tax cuts would lessen the burden on the average worker, rather than the entrepreneur and business: the central benchmark for his policies will be an improvement in America’s stagnant median wage. Mr McCain’s economic plans are more clearly focused on promoting overall growth.

The biggest difference between the two men’s domestic policies is not on the economy, but on health care. Mr Obama is determined to move America to near-universal coverage, and Mr McCain is not: he hopes to drive down overall costs through promoting more competition. Voters strongly prefer the Obama version; but it will be pricey. And money is tight.

On foreign policy, the candidates are closer than is often supposed. On all past and present form, Mr McCain would be gruffer towards Russia and China than Mr Obama, but the younger man is not about to roll over for either one. Over Iraq there are huge divides in theory; but in practice either man is likely to conduct a gradual withdrawal over the next two or three years. There are some large differences, though: Mr McCain wants a much bigger increase in military spending than Mr Obama does, and on any reasonable assessment, he is more likely to use force, if diplomacy fails, to counter Iran’s nuclear ambitions.

Whoever wins, America will tread a very different path from the gloomy one down which George Bush has taken it

With all this at stake, it would be sad if the election turned on divisive cultural issues like abortion, where the chances of resolution are slim. “Values” could yet tip the balance. Though Mr Obama shows signs of pulling ahead, this is still is a close election, with Mr McCain’s advantage on security countering Mr Obama’s on the economy. But with the markets still reeling, we think the winner is likely to be the man who shows he best understands and can help the anxious average American. This newspaper will cast its vote in our November 1st issue.

Economist.com BUSINESS

The music industry

Qualms with music

Oct 2nd 2008
From The Economist print edition

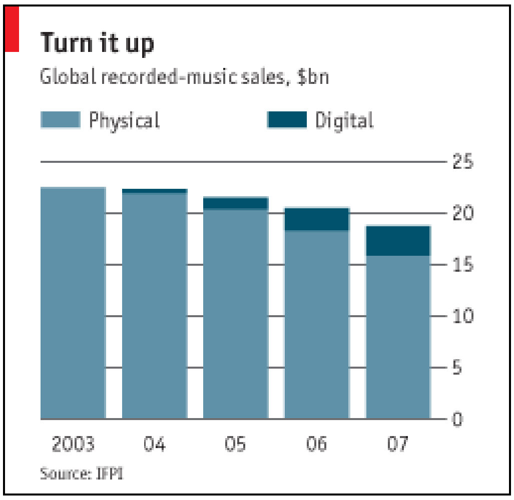
Cross-subsidised subscriptions offer a promising new model—if the sums add up

Illustration by Peter Schrank

Get article background

IT IS a gift that keeps on giving—for a year, at least. Starting in Britain this month, buyers of some handsets made by Nokia will be able to download as much digital music as they like. The handsets, starting with a model costing £130 ($230), are bundled with a year's free online-music subscription, called "Comes With Music" (CWM), launched on October 2nd. You can download music, and listen to it, on both the handset and your PC. Once the subscription expires at the end of the year, you can still listen to the tracks.

Nokia's new handsets are sure to appear under many Christmas trees this year. The offer of unlimited downloads will appeal to teenagers; and parents will not have to worry about their children getting caught downloading music illegally, or spending a fortune at online music-stores. But CWM and similar subscription services are also being touted as a potentially life-saving gift to the ailing music industry. That is because they cleverly reconcile the demands of teenagers, who think music should be free, with those of record companies, which want to make money.



The world's biggest handset-maker has pulled this off by acting as a go-between: it licenses music from the four major labels and some independent record firms at a discount, tags some of the cost onto the device's purchasing price and absorbs the rest itself. Such a deal is made possible by a convergence of interests. Sales of digital music are growing, but not fast enough to offset falling sales of CDs, partly because of internet piracy (see chart). Record companies are realising that their efforts to get young music fans to pay up are not working. Many are unwilling, or unable, to pay for downloads, and legal action results in bad publicity. So something new is needed. Nokia, for its part, wants to move beyond hardware, and considers music a way to kick-start Ovi, its new initiative to offer a range of mobile-internet services.

Both camps also have a common interest in reining in Apple, the computer-maker that dominates digital music with its iTunes download service and iPod music-players. At the moment, record

labels have to accept Apple's terms. A strong rival service from Nokia could strengthen their negotiating hand. As for Nokia, it hopes to catch up with iTunes and defend its core market against Apple's iPhone handset.

CWM is the most prominent example of a wider trend. Other companies have also started to combine their offerings with similar "all you can eat" music subscriptions. TDC, a Danish telecoms operator, has bundled such a service with its broadband connections. Orange, a European mobile operator, has launched Musique Max, which combines unlimited music downloads with a mobile-broadband service for €12 ($17) a month. And Sony Ericsson, another handset-maker, is planning to launch an unlimited music service called "PlayNow plus", which will be offered to consumers via mobile operators.

Will this new model work? For the record labels CWM is likely to be a good deal. If they receive, as some analysts have estimated, a total of €4 ($5.60) per handset per month (about half the cost of all-you-can-eat subscription services on the internet) and Nokia sells 5m CWM handsets, the additional income would add up to €240m ($338m)—equivalent to more than 1% of global recorded-music sales in 2007 and 12% of the digital business. The potential market is far bigger: last year Nokia sold 146m phones that can play music.

But Paul Jackson of Forrester, a market-research firm, worries that Nokia will end up overpaying. The firm has not released details of its agreement with the record companies, but it is said that they will receive a fixed fee per handset, have been guaranteed a large number of handset sales, and will receive additional fees once a subscriber exceeds a certain number of downloads. So the promise of "unlimited" music is actually subject to a "fair use" limit, beyond which access will be cut off.

The economics of CWM will become clearer when Nokia reveals what exactly will happen after the 12 months of free downloads are over. The company hopes that most owners will simply buy a new CWM handset, says Elizabeth Schimel, the head of Nokia's music business, since teenagers like to be seen with the latest model. (CWM could thus encourage people to upgrade their handsets more often than they otherwise would have.) But customers will also be offered the chance to switch to Ovi's paid-for music service.

The cost of that service will indicate the extent to which Nokia is underwriting the free CWM service. The level of subsidy will also determine how long CWM will remain in its current form. At the moment, Nokia's priority is to get Ovi off the ground. But over time, the firm's willingness to absorb some of the cost of a music subscription may well diminish, says Mark Mulligan of Jupiter, another market-research firm. Either the labels will have to make do with less, or other firms, such as the mobile operators, will have to pitch in. Consumers are unlikely to contribute much, simply because they will refuse to: take-up of subscription-based music services has been disappointing so far.

Even if the sums do add up, the new model may face other problems. To start with, the services will be available in only a few countries and will not compete directly: CWM in Britain (and, perhaps, India soon), Musique Max in France and PlayNow plus in Sweden. But as these services spread and start to compete, consumers may object to the fact that they are not compatible with each other. Next, record labels may have second thoughts about appearing to allow other firms to give away their wares—even if they are, in fact, paid for behind the scenes. Subsidised subscriptions will only strengthen the widely held belief that music should be free. "They are another step in the commoditisation of music," says David MacQueen of Strategy Analytics, a consultancy.

That said, unlimited music services could help to reduce piracy, by making it unnecessary. With services such as CWM, "the person with a hard-drive with 60,000 stolen files is all of a sudden deeply uncool, as other people have access to everything," says Rob Wells, a senior executive at Universal, the world's biggest record company and the label that is most keen on CWM. But they could also undermine people's willingness to pay for CDs and music downloads from iTunes and other online stores, as avid consumers of music switch to unlimited, free services instead.

"CWM is almost too good for its own good," says Jupiter's Mr Mulligan. The impact of such services is uncertain; there are many details still to be worked out; and even then they will not solve all of the industry's problems. But they are potentially a big step forward.

GE

Buffett to the rescue

Oct 2nd 2008 | NEW YORK
From The Economist print edition

Is it a bird? Is it a plane? No, it's SuperWarren

SHORT, septuagenarian and bespectacled, Warren Buffett does not resemble a typical superhero. Yet twice in barely a week he has swooped to rescue two of the world's greatest companies from tight spots. First it was Goldman Sachs, which had a near-death experience after the collapse of Lehman Brothers. And on October 1st it was GE's turn to breathe a sigh of relief, as the "Sage of Omaha" quashed market worries about its health by investing $3 billion in the huge conglomerate.

As a famously canny value investor, it is hardly surprising that Mr Buffett has an excellent understanding of his own value. As with the investment in Goldman, the terms of the investment being made in GE by his company, Berkshire Hathaway, are fantastical. As long as Hank Paulson, America's treasury secretary, manages to steer the economy away from financial Armageddon, Mr Buffett is sure to add to his reputation and his fortune. Indeed, were he not a philanthropist, committed to giving away his billions, the tough terms he has negotiated with both firms might have prompted accusations that he is taking advantage of the desperate. His preferred stock in GE will pay a dividend of 10%, and he has the right to buy a further $3 billion at a price of $22.25, below the share price when his investment was announced.

GE is offering a further $12 billion of new shares to the public, who may be inspired to follow in Mr Buffett's footsteps, though ordinary shares are a far riskier bet. But Mr Buffett has issued a much-needed vote of confidence in the firm and its embattled chief executive, Jeffrey Immelt. Though it is hard to fault Mr Immelt's strategy of shifting GE's portfolio from low-margin to high-margin activities, his seven years at the helm have not impressed investors. GE is worth barely half what it was a year ago, although with a market capitalisation of $244 billion it is hardly going out of business, which is why Mr Buffett can invest with even greater certainty of making a killing than he did with Goldman.

Most of GE's recent problems have come from its financial arm, GE Capital, which it has belatedly decided to shrink somewhat. As well as some exposure to subprime mortgages and problems in its vast credit-card portfolio, there are growing concerns about its exposure to commercial property, which has been pretty solid so far but is vulnerable to a sharp economic downturn. Investors have also worried about what would happen to GE's hybrid industrial-financial business model if it lost its cherished triple-A rating. Happily S&P, one of the leading rating agencies, said Mr Buffett's investment and the decision to raise more cash reinforced the triple-A rating.

The credit crisis surely reduces the likelihood of GE spinning off GE Capital, which can rely on the predictable cashflow from GE's industrial units to provide liquidity even when the credit markets are dry. In the summer Mr Immelt added a loyal backer by bringing in Abu Dhabi's Mubadala sovereign-wealth fund as a big shareholder. Now he has strengthened his job security even more by bringing in his friend, the famously loyal Mr Buffett.

Economist.com BUSINESS

Mergers and acquisitions

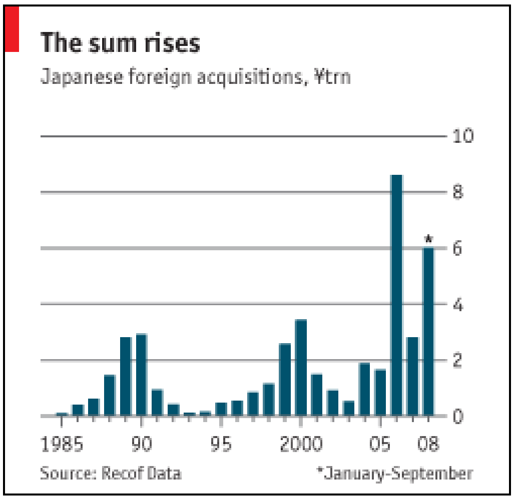
The Japanese are coming (again)

Oct 2nd 2008 | TOKYO
From The Economist print edition

Japan's cash-rich companies are buying up foreign firms

THE credit crunch has reduced merger and acquisition (M&A) activity around the world. Banks have tightened their purse-strings and the cheap credit that financed deals during the private-equity boom has dried up. This year the value of deals has fallen by 15% in America and 30% in Europe. But there is a bright spot amid the gloom: Japanese companies are on a spending spree, capitalising on the distress to buy firms abroad. The number of foreign deals involving Japanese firms has increased only slightly compared with last year, but the value of transactions has more than doubled, reaching ¥6 trillion (around $57 billion) so far this year, and on track to exceed 2006's record.

This wave of deals follows two previous forays overseas. In the late 1980s Japanese firms raced after foreign real estate, and in the late 1990s they piled into technology companies (see chart). Both binges ended badly, as companies sold their stakes at a loss and bolted for home. But things could be different this time. Instead of trophy assets such as Rockefeller Center or Pebble Beach golf course, the targets are companies that fit strategically with their acquirers, providing new technology or access to new markets.



Japanese firms can afford to be so acquisitive because, unlike companies elsewhere, they are flush with cash. Thanks to conservative managers and years of record profits, Japanese public companies are sitting on cash reserves of more than ¥60 trillion, estimates Nikkei, a financial-news company. At home, companies face a slowing economy, a cultural aversion to takeovers and an ageing and declining population. "They are pampered in cash. But they can't invest in Japan—so they go abroad," explains Shoichi Niwa of Recof Data, an M&A advisory firm.

Moreover, there are fewer rival buyers because of the difficulty of raising capital just now. Where Japanese companies lost out in bidding wars over potential acquisitions in the past, today they are winning, explains Robert Davis, the head of M&A in Europe for Nomura, a Japanese financial-services firm.

In addition, the share prices of many companies have tumbled in the financial crisis, making acquisitions more attractive, and the yen has strengthened relative to the dollar and euro, making Japanese cash go further. But the most important factor driving the deals is that after years of talking about the need to expand overseas—to achieve global scale and compete more effectively with Western firms and emerging giants from elsewhere—Japanese firms have realised that today's misery provides the ideal opportunity.

Accordingly, most of the deals are strategic. For example, Takeda Pharmaceutical paid $8.8 billion for America's Millennium Pharmaceuticals to get hold of its cancer drugs. Daiichi Sankyo paid $4 billion for Ranbaxy, an Indian maker of generic drugs with strong sales in emerging markets. TDK, an electronics firm, is spending ¥200 billion on Epcos, a German firm, to fill holes in its product line. Tokio Marine, an insurer, is paying ¥500 billion for Philadelphia Consolidated, to gain access to the American market. Even so, some deals are opportunistic: in September Mitsubishi UFJ Financial Group, a Japanese bank, paid $9 billion for a 21% stake in Morgan Stanley, a struggling American bank. And Nomura paid a pittance for the European, Asian and Middle Eastern operations of Lehman Brothers after it went bust.

Unlike in previous overseas acquisition sprees, the Japanese are regarded as good owners by foreign companies, says David Marra of the Boston Consulting Group in Tokyo. This is because they tend to be long-term investors (unlike private-equity firms) and have a good record of operating abroad (unlike investors from China or the Gulf—the only other people with money these days). They do everything they

can to retain existing managers, notes Steven Thomas, co-head of M&A at UBS in Tokyo.

The deals are likely to continue, though there is no particular rush, since the credit markets seem unlikely to rebound in the near future. But before Japanese bosses celebrate, they may want to consider that this golden opportunity is hardly the result of business perspicuity. Japanese companies had such a surfeit of unused capital because of poor corporate governance and fiscal management. Luck has provided them with the chance to go global. But they will need wisdom and skill to manage what they buy.

America's car industry

A bail-out that passed

Oct 2nd 2008 | DETROIT
From The Economist print edition

In the slipstream of Wall Street's woes, the Big Three land a huge subsidy

DETROIT seems to be where Wall Street meets Main Street. Tight credit is reckoned to have cost the American carmakers 40,000 sales in August, worth about $1 billion in revenue. The impact has been felt most by America's Big Three—General Motors, Ford and Chrysler—which have suffered this year as consumers shunned gas-guzzlers in favour of the smaller cars mostly made by Japanese firms in American factories. Overall light-vehicle sales hit a 15-year low in September, with a fall of 27% compared with a year earlier. The problem is finance. "We have plenty of customers—what we don't have is financing available to meet their needs," Mike Jackson, chief executive of AutoNation, a leading car-dealer chain, told CNBC this week. He reckons that tighter credit and limits on finance for leases have cost his firm a fifth of its sales this year.

The Big Three have been hit by petrol prices pushing towards $4 a gallon, by more demanding federal fuel-economy rules and by the credit crunch wrecking consumer finance. But the federal government came to their aid this week when George Bush signed an energy bill that includes $25 billion in loan guarantees to ease their pain. Supposedly this is to allow the Big Three to retool their factories to produce more economical vehicles. David Cole, director of the Centre for Automotive Research, an industry body, estimates that such retooling could cost at least $100 billion. But money is money, so the infusion of cheap credit will help the carmakers pay their bills next year. "Given the market position of the Big Three, things will get sticky by mid-2009, because they have to keep spending on new programmes," says Joe Philippi of Auto Trends, a consultancy.

The rules are still being worked out, but the deal means that car companies—blessed with the government guarantee—should get loans with an interest rate of around 5% rather than the 15% they would face on the open market in today's conditions. The stipulation that the loans are only for firms with factories at least 20 years old rules out nearly all the "transplant" factories that foreign carmakers built in America to get around tariff barriers. And even if some Japanese carmakers do qualify for loans, they are not expected to ask for them.

So a sum that seemed preposterous only a few months ago has won overwhelming approval from politicians. Compared with the demand for $700 billion to underpin the financial system, who can complain about a mere $25 billion for carmakers? And using government money to keep honest, hardworking car-industry workers in their jobs is easier for politicians to justify than handouts for greedy Wall Street bankers. The sales-pitch is even more compelling in an election year.

Once industrial subsidies like this begin to flow, it is difficult to stop them. A recent study by the Cato Institute, a right-wing think-tank, found that the federal government spent some $92 billion subsidising business in 2006 alone. Only $21 billion of that went to farmers: much of the rest went to firms such as Boeing, IBM and GE in the form of export-credit support and various research subsidies.

The Big Three are already complaining that it will take too long to dish out the money, and they want the process speeded up. They also want a further $25 billion, possibly attached to the second version of the Wall Street rescue bill. The logic of bailing out Wall Street is that finance underpins everything. Detroit cannot begin to make that claim. But, given its successful lobbying, can it be long before ailing airlines and failing retailers join the queue?

Economist.com BUSINESS

Liquefied natural gas

A more liquid market

Oct 2nd 2008
From The Economist print edition

EPA

A new kind of offshoring

Offshore terminals and other tricks could promote greater trade in LNG

AMID the waters of the Adriatic, some 40 kilometres (25 miles) south of Venice, a curious new structure is being installed. It is the size of two football pitches, as tall as a ten-storey building and will soon be connected to the shore by a 15-kilometre pipeline. It is a regasification terminal, which will take deliveries of liquefied natural gas (LNG) and turn it back into a gas before pumping it ashore—and it is the first such plant to be located at sea. That has allowed its owners, Exxon Mobil and Qatar Petroleum, both oil and gas firms, and Edison, a local utility, to avoid the permitting problems that have hampered regasification projects in crowded countries such as Italy. Such innovations are helping the LNG business to grow dramatically—but they are also changing it in unpredictable ways.

Natural gas is cleaner than other fossil fuels, and gas-fired power plants are relatively cheap to build, prompting a "dash for gas" by European and American utilities in recent decades. Demand for gas is still growing in rich countries, even as their thirst for oil has faltered. But domestic supplies have been shrinking. Europe, in particular, is becoming ever more dependent on gas imported by pipeline from Russia.

That is where LNG comes in. It allows producing countries to profit from "stranded gas" located far from big markets, and lets consuming countries diversify their supplies. The gas for the Adriatic terminal will come by ship from Qatar. Another 14 countries, from Indonesia to Equatorial Guinea, export LNG; 18 import it. Whereas global gas consumption is growing by 2-3% a year, according to Royal Dutch Shell, another oil and gas firm, demand for LNG is growing by 7-10%. It now accounts for a quarter of the international trade in gas.

The International Energy Agency (IEA), a watchdog for rich countries, expects LNG trade almost to double between 2006 and 2015, to 393 billion cubic metres a year. But regasification capacity is growing much faster. Existing terminals can take in 617 billion cubic metres a year, says the IEA, and others under construction should increase that to 846 billion cubic metres by 2010.

Energy firms have found clever ways to overcome permitting problems, beyond putting terminals offshore. One trick is to build plants just over the border in a more welcoming country: Sempra, an American firm, has built a regasification plant in Mexico, just across the border from California, where regulators have yet to approve such a facility. Excelerate Energy, an American firm, owns LNG tankers that can regasify their cargoes on board, and then send the gas ashore through pipelines—another way to avoid building a big onshore plant.

Most LNG is still sold under long-term contracts that underpin the huge investments required for liquefaction plants. But the surfeit of regasification capacity has created opportunities to divert cargoes to the most lucrative market. Last year, for example, an earthquake in Japan forced the closure of several nuclear plants, leading to a surge in demand for gas for power generation. Several LNG shipments were

diverted from the Atlantic to Asia to take advantage of the higher prices on offer there. As a result, the number of shipments arriving at an American terminal belonging to BG, a big gas firm, fell from 48 in the second quarter of the year to one in the fourth.

The prohibitive expense of building liquefaction plants will prevent any completely speculative developments, says Umberto Quadrino, the boss of Edison. But some global gas giants are committing to buy ever more LNG from liquefaction plants without lining up subsequent buyers, which will let them sell it to the highest bidder instead. The proportion of LNG in the hands of such middlemen will rise from 12% to 25% when all the plants now under construction start running, says Michael Stoppard of Cambridge Energy Research Associates, a consultancy.

Yet the price LNG will fetch depends on supply as much as demand. Technological innovations might yet make it cheaper to produce. Shell, for example, hopes to build offshore liquefaction plants that could be towed from one gasfield to another, dramatically reducing overheads. Other firms plan to ship compressed, rather than liquid, gas—a less capital-intensive process that might make smaller fields profitable.

Meanwhile, America has recently reversed a steady decline in domestic gas production, thanks to new technology that allows firms to tap previously inaccessible gas trapped in coal, shale and some types of sandstone. Gas production in America grew by 4.3% last year, and by 9% in the first quarter of this year. This unexpected spurt will delay America's emergence as a big importer of LNG by a decade, in Mr Stoppard's view. And America is not the only country with big reserves of "unconventional" gas. Firms in Australia and Canada are rushing to adopt the same technology. Any country with lots of coal, including China, India, Russia and much of Europe, should be able to increase gas output in the same way. Several firms in Australia even plan to use such gas to make LNG.

Face value

The specialty generalist

Oct 2nd 2008
From The Economist print edition

Hans Wijers of AkzoNobel has taken an unusual path to the top of Europe's chemical industry

Clarification to this article

AkzoNobel

JUST as America's dodgy subprime mortgages were triggering the credit crunch in August last year, Hans Wijers, the boss of AkzoNobel, a European specialty chemicals company, shook hands with John McAdam, the boss of ICI, to seal a takeover that had been rumbling for months. AkzoNobel's two previous bids had been rebuffed, but when Mr Wijers raised his offer price to £8 billion ($16 billion), ICI capitulated—spelling the end for one of Britain's most famous companies and one of the biggest names in chemicals. The combination of ICI's strength in America and Asia with AkzoNobel's clout in Europe transformed a stolid regional company into a powerful global competitor, and turned AkzoNobel into the world's biggest maker of paints. Yet the architect of the merger, Mr Wijers, had no reputation as a dealmaker—indeed, he was a newcomer to senior management when he was appointed as AkzoNobel's chief executive in 2003.

Mr Wijers's path to the top of the European chemical industry has been far from straight. His unusual background, plus some lucky timing, have helped him get there. His career refutes the old joke that those who can't do teach, and those who can't teach become consultants, since he has been both of those things, and a politician too. After a stint as an assistant professor teaching economics at Erasmus University in Rotterdam, he worked as a civil servant in the Dutch Labour Ministry and then as a consultant with Boston Consulting Group (BCG), before being drafted into a coalition government as minister of economic affairs in the mid-1990s. He made his mark by modernising competition law and deregulating business. “Even now I am sometimes stopped in the supermarket by people who thank me for allowing shops to remain open in the evening,” says Mr Wijers. Before his intervention, an unholy alliance of retailers and trade unions ensured that the shutters across the Netherlands came down at 5.30pm.

After four years in government, Mr Wijers spent a further five years as a senior vice-president at BCG, before being offered the top job at AkzoNobel. Within a year he had mapped out a new strategy for the company. At the time, Europe's chemical industry was changing fast as the traditional model—in which conglomerates made everything from ammonium phosphate to zinc alkyls—crumbled. The old approach was typified by ICI: at its height, it ranged from heavy petrochemicals to fancy pharmaceuticals. During the 1990s it set out to transform itself from a stodgy conglomerate to a more focused maker of specialty chemicals, starting with the sale of its pharmaceuticals arm, which is now part of AstraZeneca. It hoped that a greater emphasis on premium products would isolate it from cyclical demand for bulk chemicals. But ICI came unstuck when it tried to pay for the purchase of Unilever's high-margin specialty chemicals

business by selling its petrochemical and heavy-chemicals units. It unloaded businesses at the low point in the industry's business cycle, and ended up saddled with £4 billion of debt. ICI began to unravel and the vultures began to circle.

As he reviewed AkzoNobel's strategy, Mr Wijers saw the industry with the sharp focus of an outsider—and concluded that ICI had taken the right approach, though it had botched the execution. He decided to take a leaf out of its book, focusing AkzoNobel on paints, coatings and specialty chemicals. He overhauled AkzoNobel's pharma unit and sold it to Schering-Plough in early 2007 for €11 billion ($14.5 billion). He then used the proceeds to swoop on ICI itself. Mr Wijers also sold part of ICI to Henkel, a German chemicals group, to avoid antitrust problems and raise more cash. As a result, he was able to fold ICI into AkzoNobel while also buying back €3 billion of AkzoNobel shares. On September 29th Mr Wijers detailed his plans to extract £100m in cost savings by cutting out overlaps between the merged companies, along with at least 3,500 jobs from a global workforce of 60,000.

Mr Wijers's timing was fortuitous, in two ways. He picked up the slimmed-down ICI at a good price. And he did not have to borrow to pay for it. As a result AkzoNobel, which has little debt, has been relatively unscathed by the credit crunch. Admittedly, Mr Wijers said this week that the planned buyback of a further €1.6 billion of shares would be suspended, because of the cost in today's markets of rolling over €1.8 billion of maturing debt in the coming months. "Normally for a company with our bond rating that would be a no-brainer, but not today," he says. The firm plans to wait until better refinancing terms become available.

Hold on tight

For Mr Wijers, as for other chief executives, the big question now is whether his company is well-placed to weather an economic slowdown. Although the fallout from the credit crunch is bound to hurt sales growth, Mr Wijers comforts himself that three-quarters of his firm's revenue comes from businesses that are relatively non-cyclical. AkzoNobel sells essential ingredients to food and drinks firms, paper-makers, printers, furniture manufacturers and so on—the type of businesses that plough on solidly through recessions. Highly cyclical sectors such as aerospace, agrochemicals and carmaking comprise a little over a quarter of its sales. Although AkzoNobel is the leading supplier of paints, America's housing slump should not affect it too badly, since decorative paint in America accounts for less than 10% of total sales.

If recession worries get him down, Mr Wijers draws comfort, appropriately enough, from the paintings that feature so prominently in AkzoNobel's Amsterdam offices. His favourite—a colourful landscape by Frank Broom depicting Lindberg, a hilly corner of the Netherlands—has hung on every one of his office walls since 1992. Since then he has climbed to the top in several fields, taking the same approach in each case. "You always have around you specialists who know much more than you," he says. "So you ask them questions and you challenge them on their answers. And from time to time, you have to make decisions."

Clarification: An earlier version of this article was accompanied by a photograph of Mr Wijers standing before an outdated logo for AkzoNobel. This picture was substituted on October 3, 2008.

Money markets

Blocked pipes

Oct 2nd 2008 | LONDON AND NEW YORK
From The Economist print edition

When banks find it hard to borrow, so do the rest of us

Illustration by David Simonds

ANY good tradesman will tell you the importance of the bits of a house that you cannot see. Never mind the new kitchen: what about the rafters, the wiring and the pipes? So it is with financial markets. The stockmarkets are the most visible: as they soar or swoon, the headline-writers get to work. The money markets, however, are the plumbing of the system. Normally, they function efficiently and unseen, allowing investment institutions, companies and banks to lend and borrow trillions of dollars for up to a year at a time. They are only noticed when they go wrong. And, like plumbing, when they do get blocked, they make an almighty stink.

At the moment, these markets are well and truly bunged up. In the words of Michael Hartnett, a strategist at Merrill Lynch, “the global interbank market is effectively closed.” The equivalent of a run on banks has been taking place, without the queues of depositors seen outside Northern Rock, a British mortgage bank, last year. This stealthy run has been led by institutional investors and by banks themselves.

Many banks have had to be rescued by rivals or the state. This week the Irish government felt compelled to guarantee the deposits and some other liabilities of the country’s six largest banks. Surviving banks have become ultra-cautious—“just taking things one day at a time,” says Matt King, a strategist at Citigroup.

The effect has been most dramatic in the overnight rate for borrowing dollars. Bank borrowing costs reached 6.88% on September 30th, more than three times the level of official American rates, while some were willing to pay a remarkable 11% to borrow dollars from the European Central Bank (ECB). Banks have become so risk-averse that they deposited a record €44 billion ($62 billion) with the ECB on September 30th even though they could have earned more than two extra percentage points by lending to other banks. It was the last day of the quarter and, for balance-sheet reasons, banks were particularly keen to have cash on hand. (Overnight rates fell back on October 1st, but one-month rates rose further, indicating that the crisis had not eased.)

In the absence of private-sector lenders to banks, central banks have become vital suppliers in the money markets. With the help of the ECB, the Bank of England and the Bank of Japan, the Federal Reserve agreed to lend a further $620 billion on September 29th (see article). That package, though of

similar size to the Bush administration's $700 billion bail-out plan, did not need congressional approval or attract public opposition.

But central banks can only do so much. In particular, they tend to lend for short periods and then only against collateral with a high credit rating. That still leaves banks with the problem of financing their more troubled assets, an issue the Bush administration's plan was designed to solve.

The money markets' difficulties began in July 2007, when two Bear Stearns hedge funds revealed the damage done to their portfolios by subprime mortgages. Since August of that year, central banks have been intervening to keep them functioning, with a series of schemes like America's Term Auction Facility. But the collapse of Lehman Brothers, followed by the long series of rescues in Europe and America, seems to have brought the money markets close to breakdown. Even immediate passage of the Bush plan would not solve all their problems straight away, because it would take time to put the plan into place.

Why do these markets matter? First, the rates on loans paid by many consumers (adjustable-rate mortgages, for example) and companies are set with reference to the money markets. Higher rates for banks mean higher rates for everyone. Second, if the markets are blocked for more than a week some companies may find it hard to get any finance at any price. That could mean more bankruptcies and job losses. Third, more banks could go bust if the blockage continues, making investors even more risk-averse. The downward spiral would take another turn.

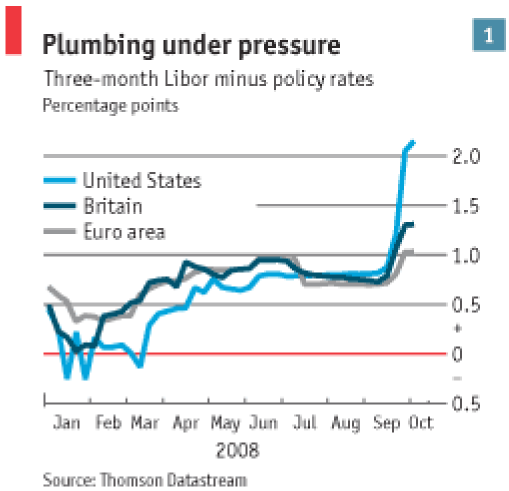
"We are at the juncture where more widespread and permanent support is required to restore confidence in the banking sector," say analysts at the Royal Bank of Scotland (RBS). "Without it, the banks will be aggressively trying to contract their books and will be unable to provide credit to retail and corporate clients."

So it is safe to say that, until the money markets behave more normally, the financial crisis will not be over. And until the financial crisis is over, the global economy may not recover.

Liquid dynamite

First, the problem. It is widely assumed that central banks set the level of interest rates in their domestic markets. But the rate they announce is the one at which they will lend to the banking system. When banks borrow from anyone else (including other banks), they pay more. Every day, this rate is calculated through a poll of participating banks and published as Libor (London interbank offered rate) or Euribor (Euro interbank offered rate).

Normally, these are only a fraction of a percentage point above the official interest rates. But that has changed dramatically in recent weeks (see chart 1). Take the cost of borrowing dollars. On October 1st banks had to pay 4.15% for three-month money, more than two percentage points above the fed funds target rate. In theory, three-month rates could be that high because markets are expecting a sharp rise in official rates. But that is hardly likely, given the depth of the crisis.



Instead, the width of the margin reflects investors' worries about the banks, not least because so many have faltered so quickly. Three months is now a long time to trust in the health of a bank. In addition, banks are anxious to conserve their own cash, in case depositors make large withdrawals or their money gets tied up in the collapse of another bank, as with Lehman.

One way this risk aversion shows up is in the "Ted spread" (see chart 2), the gap between three-month dollar Libor and the Treasury-bill rate. After being as low as 20 basis points (a fifth of a

percentage point) in early 2007, the spread is now 3.3 percentage points. In other words, the relative cost of raising money for banks has risen 16-fold in the past 18 months.

Indeed, some banks argue that Libor and Euribor understate the full extent of the increase in banks' borrowing costs. According to John Grout of the (British) Association of Corporate Treasurers (ACT), banks have started to talk to companies about invoking the "market disruption" clause in loan contracts. This would allow them to replace the two benchmarks with the "real" cost of their funds, which they say would be higher. (Companies usually pay Libor or Euribor plus a margin that depends on the riskiness of their finances.) One company, Hon Hai of Taiwan, an electronics manufacturer, says its banks have already invoked the clause.

This affects only debt facilities that have already been set up. Mr Grout says that when companies are negotiating new loans with banks, they are being asked to accept rates based on Libor plus a quarter of a percentage point. Unsurprisingly, the ACT is unimpressed with this tactic, since Libor is calculated from data supplied by the banks themselves.

Companies do not have to borrow from banks; they can raise money from the markets by selling commercial paper, a type of short-term debt. For much of this year, that was an attractive option. The preference of investors for debt issued by non-financial companies made commercial paper a source of cheap finance.

But in recent weeks even this has become more difficult. The volume of commercial paper outstanding fell by $61 billion to $1.7 trillion in the week ending September 24th. And investors are unwilling to lend for long: AT&T, a big American telecoms company, said on September 30th that the previous week it had been unable to sell any commercial paper with a maturity longer than overnight. The volume of asset-backed commercial paper maturing in four days or less ballooned from $32 billion a day to $104 billion during September (see chart 3), while the amount maturing in 21 to 40 days fell by 63%.

Where there is doubt about a company's finances, it inevitably has to pay a higher rate. Worries about GE, one of America's most prestigious companies, pushed up the premium on its credit-default swaps and made raising short-term debt dearer. According to the *Wall Street Journal*, the rate on its commercial paper had gone up by two-fifths of a percentage point. That might not sound much, but GE has $90 billion of paper outstanding, so it faced an extra interest bill of $360m a year. On October 1st the company announced a $12 billion public share offering and a $3 billion injection from Warren Buffett, a leading investor.

Why has commercial paper lost its shine? The explanation seems to lie back in the authorities' willingness to allow Lehman to collapse. That move, designed to warn the markets that the authorities took moral hazard seriously, has had some unintended consequences.

Fund of surprises

The most severe was the loss imposed on the Reserve Primary fund, a money-market fund. Such funds invest in short-term debt and offer investors higher rates than on bank deposits. But they also aim to repay their customers at par. Because it had bought Lehman debt, the Reserve Primary fund was forced

to “break the buck” (that is, to repay less than 100 cents on the dollar), only the second such instance in the industry’s history. This caused a crisis of confidence in money-market funds. “Prime” funds, which offer slightly above-average rates in return for higher risk, have lost about $400 billion out of $1.3 trillion in the past few weeks, as investors have switched to funds based on government debt. In turn that has made other funds more cautious and led them to steer clear of bank loans and commercial paper.

Illustration by David Simonds

Buried among the many recent American regulatory initiatives was a scheme to insure money-market funds against failure. That scheme may have halted a stampede by retail investors out of the industry, but it has not restored the level of confidence of two months ago and new deposits do not qualify.

At the same time as they are struggling to raise money from outsiders, banks may face more claims on their capital. In the good times they promised to provide back-up loans to companies—which they thought would never be asked for. On some estimates, the value of these promises is $6 trillion. But with the commercial-paper market tightening and the economy deteriorating, more companies will be asking banks to keep their word.

Indeed, companies already seem concerned that banks will be unable to maintain promised loan facilities. So they are using those credit lines earlier than expected, in case they vanish. A prime example is Duke Energy, an American utility, which recently drew down $1 billion from a credit agreement. Chris Taggert of CreditSights, a research group, foresees a “funding blitzkrieg” by high-yield borrowers tapping their banks for cash if the mayhem does not abate.

“There’s a vicious-spiral element to the inability of companies to roll commercial paper,” says Ajay Rajadhyaksha, a fixed-income strategist at Barclays Capital. “Those that have back-up lines of credit with banks are increasingly drawing on them. This is hurting the banks, and making money-market funds even queasier about buying bank debt, and so on.”

CreditSights notes that it has become more common for companies to call on these loans amid “fears that bank lenders may not be able to honour commitments in the future.” Several of these companies, including General Motors, have cited the uncertain state of capital markets when asking for their money. Goodyear Tire & Rubber said it was drawing down its loans because some of its cash was locked up in, of all places, the Reserve Primary money-market fund.

Whatever the reason, the possibility of more calls from their corporate clients is another factor behind the banks’ desire to hold cash. That will mean any company without a back-up facility may struggle to raise new loans.

Luckily, most companies are not as exposed as they were when the dotcom bubble burst. Nevertheless, plenty of carmakers and retailers have mountains of debt or a strong need for cash. Then there are companies that underwent leveraged buy-outs. The private-equity groups that bought them may have been counting on refinancing their debts soon.

A lack of access to capital is sure to make companies cautious. “Your ability to plan for investment is obviously affected,” says Randall Stephenson, chairman and chief executive of AT&T. In addition, higher finance costs will eat into profit growth, a fact that seems yet to be recognised in buoyant forecasts for 2009. “The equity market is going through the slow process of realisation that a large proportion of earnings growth over the last 25 years was due to the falling cost of money,” says Kit Juckes, an economist at RBS.

Polonius’s revenge

Consumers have been going on a greater debt binge than companies and the impact on them may be more immediate. In particular, they may face higher mortgage and credit-card rates. Some may be denied new credit altogether.

The last survey of senior loan officers by the Federal Reserve was back in July. Even then 65% of banks were tightening their lending standards on credit cards, up from 30% in April. Consumers had not felt the effects by then: credit-card lending rose by 4.75% in the year to July, although other types of credit barely grew at all.

Mortgage costs have also been rising for those with variable-rate loans. On September 30th, American adjustable-rate mortgage rates were 6.13%, according to Bloomberg, compared with 5.92% at the end of August and less than 5.5% in the spring. In Britain three leading lenders raised rates by half a percentage point in the week to September 26th. And Moneyfacts, an information group, says the number of buy-to-let mortgages (used by private landlords) has fallen 85% over the last year.

These effects might teach voters that punishing the banks for their follies is sometimes cutting off their noses to spite their faces. “At some point Main Street will realise it lies on the same road as Wall Street,” says Mr Juckes.

It is not too difficult to imagine bank failures leading to job losses, further falls in house prices, bad consumer debts and further bank losses. “We may already be at the point where corporate fear and conservatism are baked in: even if things start to improve for the banks, companies have seen how bad things can get, and that can prove lasting,” says Torsten Slok, an economist at Deutsche Bank. “So there is a risk they’ll continue to hoard cash and mistrust banks for quite some time.” That is the kind of spiral which the Bush administration’s plan was designed to avoid.

Relying solely on ad hoc rescues of individual banks would only make investors more nervous about the banks that remain. The financial plumbing would stay bunged up. Unless something is done to unblock it soon, there will not just be a nasty stink in the markets. There will also be an unholy mess in the wider economy.

Economist.com OPINION

Foreign exchange

The buck swaps here

Oct 2nd 2008
From The Economist print edition

Central banks ease the market's pain

A BIG problem for the banks has been a shortage of dollars in the money markets, particularly in the European morning before the New York market opens. That is one reason why dollar interest rates have been so high relative to those for euros.

Normally, investors and banks would arrange foreign-exchange swaps among themselves, agreeing to switch euros into dollars for a set period. But banks are nervous about the risk that their counterparty will go bust while the swap is being put in place and so are shying away from such agreements.

Hence the facility set up by the Federal Reserve on September 29th to supply $620 billion to its counterparts, so that they can lend them on to banks. At first glance, this may seem to be a back-door bail-out on a similar scale to the plan proposed by Hank Paulson, the American treasury secretary.

There are some similarities in that the central banks involved in the swaps make loans secured on assets that commercial banks pledge as collateral. If that collateral falls in value, the central banks could lose money. But the collateral is generally of much higher quality than the troubled assets that were the subject of the bail-out plan, and the central banks generally apply a discount when assessing the collateral's value. Furthermore, the Fed (and thus the American taxpayer) is lending its currency directly to other central banks, and thus has no real credit risk.

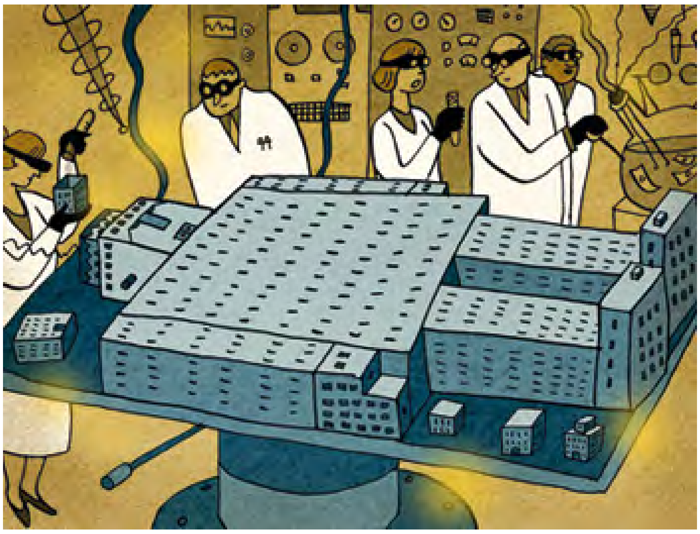
Global banks

On life support

Oct 2nd 2008
From The Economist print edition

Governments in America and Europe scramble to rescue a collapsing system

Illustration by S. Kambayashi



AFTER lurching robotically into their worst crisis in more than three-quarters of a century, the fundamental weakness of banks in America and Europe has now become horribly clear. With funding markets frozen and American plans to remove toxic assets from banks' balance-sheets in limbo for much of this week, confidence in a raft of institutions evaporated. Between September 28th and 30th, governments on both sides of the Atlantic shored up or split up six banks threatened by failure. Other institutions remain on high alert.

Observers scratch their heads to think of any other industry that has been reshaped so quickly or so dramatically. In America, where the authorities have helped to shovel failing banks into the hands of bigger ones, the retail-banking landscape now has three towering figures. On September 25th JPMorgan Chase overtook Bank of America as the country's largest deposit-taking institution by snapping up the assets and deposits, but not the other liabilities, of Washington Mutual (WaMu), a Seattle-based savings-and-loan bank that had been suffocated by bad mortgage loans.

Four days later Citigroup, its risks capped by a loss-protection agreement with the Federal Deposit Insurance Corporation (FDIC), strengthened its domestic deposit base by acquiring the banking operations of Wachovia. Further consolidation is likely. Jim Eckenrode, an analyst at Tower Group, a consultancy, reckons that a top tier of five banks (Wells Fargo and US Bancorp are two other contenders) may end up holding as much as half of America's deposits.

In Europe the pace of consolidation has not been quite as rapid but the scale of government intervention is just as breathtaking. The continent has turned into a laboratory of bank bail-outs. One approach has been to inject equity into institutions and try to keep the show on the road. Fortis, a Belgo-Dutch bank overstretched by its role in acquiring ABN AMRO, is now part-owned by the Benelux governments. The Icelandic government has taken a 75% stake in Glitnir, a bank with outrageous reliance on gummed-up wholesale funding markets. The French, Belgian and Luxembourgeois authorities stumped up €6.4 billion ($9.3 billion) to bolster the capital base of Dexia, a public-sector lender that dabbled fatally in bond insurance.

Another approach has been to borrow from the American model, parcelling out the good bits of failing banks to solvent rivals and keeping the rest. The deposits and branches of Bradford & Bingley, a British mortgage lender that made Northern Rock look well managed, are now in the hands of Santander, a respected Spanish bank. Its mortgage book now rests with the luckless taxpayer. Germany's Hypo Real

Estate, a commercial-property lender which found that the tenor of its funding was becoming shorter as investors shied away from long-term lending, got help of a different sort—a €35 billion secured-credit facility from a consortium of unnamed German banks and the government.

The most sweeping intervention of all came from Ireland's government, where concerns about spiking credit-default swap (CDS) spreads, falling share prices and jittery depositors led the finance minister to announce, on September 30th, a blanket guarantee on the deposits and almost all the debts of the country's six biggest banks until September 2010. "The Irish move confirms that this is a systemic crisis in certain countries," says Simon Adamson of CreditSights, a research firm. Investors and creditors of Irish banks liked the move, which recalled one of the actions taken by Sweden during its feted 1990s bail-out. The European Commission and other banks, worried about deposit flight to Ireland, are bound to be less enthused.

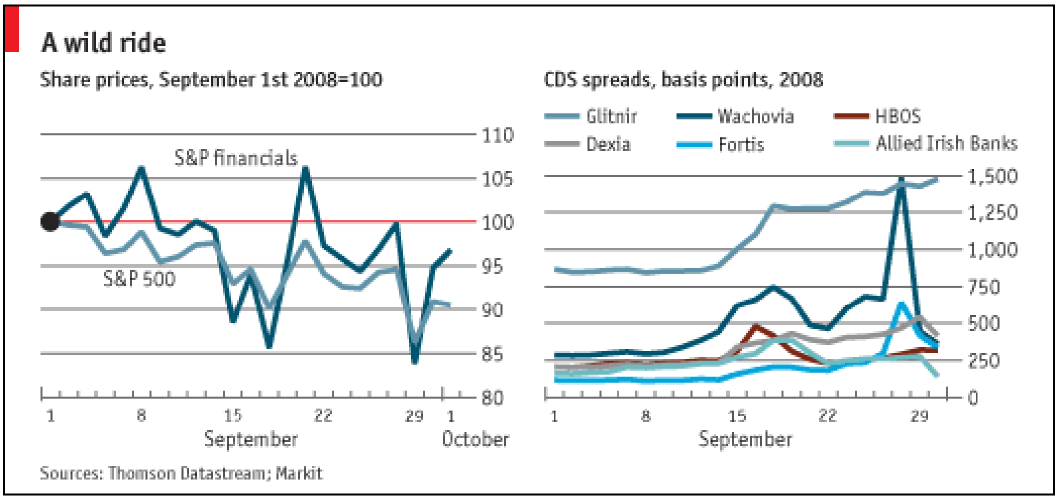
Safe as houses

All this activity had one immediate prize: not a single bank needed rescuing on October 1st. But for those with longer-term horizons, the future remains bleak, and in some ways, worse than before. There are two sources of pressure on the banks. To date government intervention has tended to focus on one or the other, but not both.

The first source of pressure is concern about solvency, and the ability of banks to withstand further losses. The unexpected rejection of the American bail-out plan on September 29th cast doubt on one obvious mechanism to remove the worst-performing assets from banks' balance-sheets. But even if it is revived, as most expect, the cycle of losses will continue as the drumbeat of bad economic news intensifies. WaMu and Wachovia were undone not by mark-to-market losses, after all, but by the appalling quality of their loan books. It is the same story in many parts of Europe.

The second source of pressure is liquidity. Even the most solid-looking banks are having trouble raising long-term debt. As their debt matures, they are having to refinance with shorter-term debt, ratcheting up their costs and their vulnerability to a sudden withdrawal of credit. If banks have enough funding through deposits, problems in the wholesale markets should be navigable. But others are much weaker. Witness the continuing pressures on Morgan Stanley and Goldman Sachs, despite their conversion into bank holding companies. Mitsubishi UFJ, a Japanese bank, lost more than $500m on its $9 billion investment in Morgan Stanley on September 29th, the day the deal was inked.

The problem is that attempts to shore up liquidity do not necessarily address the capital shortfalls, and vice versa. Even Ireland's lavish guarantee does not quell concerns about rising impairments on the Irish banks' property portfolios. Glitnir's capital ratio looks robust after the government's investment, for example, but its CDS spreads still surged, indicating rising fears of a national crisis (see chart).



Worse still, the effect of most government interventions, necessary as they are, is to make it even harder for private investors to heal the system on their own. Shareholders are losing both money and reputations as bank failures multiply. TPG, a vaunted private-equity firm, was wiped out by the collapse of WaMu. Shareholders in Wachovia, Fortis and Bradford & Bingley had all recently dipped into their pockets to raise fruitless capital. The risk of sudden dilution by governments, or worse, hangs darkly over prospects for industry recapitalisation. Creditors have also become far more risk-averse in recent days, thanks to the

bankruptcy of Lehman Brothers and the brutal treatment of WaMu’s senior creditors (see article). Hypo Real’s new credit line will presumably have shunted unsecured creditors down the queue too.

So far only the Irish solution has avoided this adverse effect, by indemnifying most creditors and allowing shareholders to reap the subsequent gains. Moral hazard, it seems, can go hang. So too can other governments, which are under pressure to match the Irish guarantee but may not be able to, either because their sovereign-debt rating is less strong or because the liabilities of their banks are too big.

There are other dangers in the rapid consolidation of the sector. A world of fewer, bigger banks promises even greater havoc if one was ever to fail (see article). The universal banks have remained largely above the fray in recent days, but on October 1st, UniCredit, a big Italian bank, announced plans to raise its capital ratio by spinning off property assets. If banks of this size and geographical scope were to get sucked into the mire, the consequences would be devastating. In the meantime, they have little choice but to present a steely exterior and carry on as if nothing were wrong.

Bank slogans

Ad nauseam

Oct 2nd 2008
From The Economist print edition

Because they're worthless

WHILE financial firms were taking giant punts to give their profits some va-va-voom, their marketing departments were conjuring up phrases to convey the impression that banks and insurers, like diamonds, were forever. Now that the future's not bright, it is obvious that some were probably the worst corporate slogans in the world. From American International Group, a collapsed insurer ("the strength to be there"), through to Lehman Brothers ("where vision gets built") and IndyMac, a failed bank ("you can count on us"), boastful institutions snapped, crackled and popped under pressure.

The home of the whoppers is America, but the trend has been connecting people globally. In incredible India, ICICI, despite being the bank of a billion smiles, was led to deny rumours of a run. And pure, natural, unspoilt Iceland has bailed out its third-largest lender, Glitnir, which although fast, smart and thorough, faced a funding crisis.

Yet not all banks failed to do exactly what it said on the tin. Through their slogans, Benelux's lenders gave an eerie premonition of the massive state rescues to come. Dexia warned that "the short term has no future," and Fortis asked, "here today, where tomorrow?" Not since Enron invited the world to "ask why" has an interrogative slogan been as prescient.

And consider also the few, the proud, that chose just to do it and openly advertise their risks. Countrywide promoted itself as a "lender that actually finds ways to make loans". (When debtors lost their passion to perform, it was bought for a reassuringly expensive price by Bank of America.) The mortgage agency Fannie Mae, now state-controlled, fully disclosed that "as the American dream grows, so do we," making clear what would happen if the world lost its faith in America. And no one comes close to Washington Mutual, whose slogan ("Whoo hoo") should have given investors a clear warning about its risk appetite. Hello Boys! Wasn't it obvious?

Cross-border rescues in Europe

Waiting for the big one

Oct 2nd 2008
From The Economist print edition

A dangerous fault-line runs through European banking

IF A week is a long time in politics, in finance it can be an eternity. In just a few days some of Europe's leaders changed their attitude from *Schadenfreude* over America's banking woes to near-panic as banks teetered in Britain, Ireland, Germany, France, the Benelux and Iceland.

The fear that spread through the wholesale money markets after the bankruptcy of Lehman Brothers, and the crumpling of several of the European banks that relied on them for funding, may have caught some of the region's politicians by surprise. But by mid-week bank supervisors across Europe (hardly a sanguine lot at the best of times) were heaving a collective sigh of relief. With remarkably little muddle, five banks in seven countries had been bailed out or culled.

That these rescues happened at all offers some comfort to those who fear for the stability of Europe's banking system. Before this week many (regulators included) had worried that it would be impossible to rescue a cross-border bank at short notice. Although the region's banks operate across the EU's single market almost unfettered by national boundaries, their regulation is still tied to national governments. Supervisors in a country hosting the operations of a bank from another may have little idea of its health. Those in its home country, meanwhile, may have little interest in what happens abroad if it fails.

Besides supervision, there are conflicting legal (and insolvency) systems, an enduring reluctance of regulators to clip the wings of their national champions, and a recognition that taxpayers would probably balk at being asked to support depositors in another country. Those all seemed to make the chances of co-ordinating action to save European banks remote.

With Fortis, the first of Europe's big cross-border banks to founder, the impossible was made to look easy. "I'm amazed they've pulled it off thus far," says a former central banker. When confidence in the bank began to seep away, the governments of Belgium, the Netherlands and Luxembourg—the three countries in which it has its main businesses—clubbed together, partially nationalised the bank and shored up its balance sheet with a capital injection of €11.2 billion ($16.2 billion). Two days later Belgium and France (with a bit of help from Luxembourg) injected €6.4 billion into Dexia, another wobbler.

AFP

Benelux v Frabelux

It may, however, be premature to celebrate these narrow escapes. There are potential pressure points right across European finance. National governments have mostly acted unabashedly in their own interests, especially Ireland's. At the times when governments have acted together, as with Fortis, they have carved banks up into their national chunks and dealt with their own part.

And although Europe has come face to face with systemic risk, it has yet to find a system-wide solution.

There are some improvements under way. The European Commission proposed on October 1st tightening the rules governing how much capital banks should hold and improving co-operation between different bank supervisors. Calls for the creation of a single European financial regulator that would watch over the continent’s biggest banks, and a pan-European bail-out fund to rescue them, are also growing louder—a group of prominent academics demanded both in an open letter to Europe’s leaders on the same day. But, so far, countries like France and Germany have been unable to agree on a pan-European rescue fund. A huge redesign of a region’s safety apparatus in the midst of a panic is a lot to ask for. But in this crisis, politicians are learning that to be effective, they have to be bold.

The Federal Reserve

Plan B

Oct 2nd 2008
From The Economist print edition

With or without the bail-out bill, the Fed has its work cut out

WITH strains intensifying in the money markets, the Federal Reserve still faces the burden of averting a serious recession. This was true whether or not America's House of Representatives approved the proposed $700 billion mortgage-rescue bill to create the Troubled Asset Relief Programme (TARP).

As *The Economist* went to press, the House had not yet voted again on a bill, after its rebellion on September 29th. The bill would permit the treasury secretary to acquire mortgage-related assets either in auctions or direct purchases, and if they are short of capital, to put equity into weakened institutions. (Half the money would be available now; the other half subject to congressional approval). Participating firms would have to give the government some form of equity or debt interest and accept limits on executive pay. A five-member oversight board and an inspector-general would monitor the programme. To win approval in the Senate on October 1st, the bill was amended to increase the limits on federal deposit insurance (see article).

But even if the House approves it, the plan will not deal with the immediate economic threat, which is a collapse of confidence in the financial system. Money-market funds and banks are deeply suspicious about whom they can entrust their money to. That could stifle the supply of credit and cause more banks to fail.

The most obvious way for the Fed to help is to lower the federal funds rate target, which sets the cost of borrowing, from its level of 2%. Markets expect a half-point cut by year-end. Lower interest rates would boost confidence, and that effect would be multiplied if the Fed acted in concert with other central banks. But the money markets are so dysfunctional that the benefits of a lower fed funds rate might be lost on most borrowers. And the European Central Bank (ECB) may not go along while it is focused on the risk of inflation, says Julian Callow, of Barclays Capital.

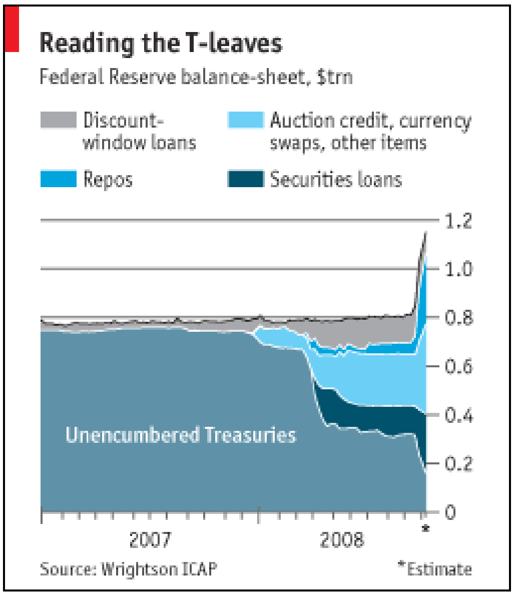
So although a rate cut remains on the table, the Fed will continue for the moment to rely on the growing use of its balance-sheet to counter the credit crunch. It has created many lending programmes since August 2007 to help banks finance holdings of illiquid assets and so avoid fire sales. But its balance-sheet is running up against constraints.

When the Fed makes loans, it deposits the proceeds in the accounts it holds for its customers—the banks themselves. Until now it has not paid interest on those deposits, which means banks lend their excess reserves to other banks. All else being equal, that would push the fed funds rate below the Fed's target, which is why it sterilises those excess reserves by selling some of the Treasuries in its portfolio.

So far, so conventional. At the end of July last year, the Fed had $760 billion of unencumbered Treasuries, or 87% of its assets. But the Fed's lending commitments have soared: $29 billion to back the assets of Bear Stearns, a failed investment bank; $85 billion in support of American International Group, an insurer; eventually $300 billion in discount-window credit auctioned to banks; and a vast $620 billion "swap" line which foreign central banks use to lend dollars to their own banks. It has also pledged to swap $200 billion of its Treasuries with investment banks. By October 1st Wrightson ICAP, a money-market research firm, reckoned the Fed had just $158 billion of unencumbered Treasuries left (see chart).

The Treasury has helped the Fed out by issuing additional debt exclusively for its use. This helps soak up the excess reserves created by the Fed's numerous loan programmes, which has caused its balance-sheet to balloon to $1.2 trillion. But the Treasury has congressional limits on how much debt it may issue. In search of a permanent way round the problem, the Fed has asked Congress to let it pay interest on bank reserves. It could then expand its balance-sheet indefinitely without driving the fed funds rate to zero; a bank will not lend out excess reserves at

0.25% if it can earn 1.75% at the Fed. The new bill would raise the debt ceiling and permit the Fed to pay interest on reserves immediately.



But even unlimited Fed liquidity may not fix the money markets. The Fed's torrent of cash pushed the fed funds rate down to 1% this week, from a high of 6% in the wake of Lehman's failure. But few borrowers benefited: some creditworthy firms paid 5% on overnight commercial paper this week and European banks paid 11% for overnight dollar funds from the ECB on September 30th. This partly reflects a temporary quarter-end scramble for funds. Burned on Lehman debt, many money-market mutual funds have also stopped buying commercial paper. Banks have picked up some of the slack, but many are reluctant to lend because their capital bases are already suffering from loan losses, and they are uneasy about the ability of many customers to roll over the paper. More lending by the Fed cannot create capital or trust; it is counting on the $700 billion bail-out plan for that.

If the plan fails to pass, the Fed could conceivably create one itself for mortgage assets, argues Michael Feroli, economist at JPMorgan Chase. The template is its September 19th announcement that it would finance banks' purchases of asset-backed commercial paper from money-market funds. The Fed, not the banks, bears the risk of any default on the paper. The risk here would be political: the Fed would be taking upon itself to intervene in the markets. But perhaps that is just what Congress would prefer: all the benefits of a rescue plan without the voters' retribution.

Buttonwood

Weaken the sinews

Oct 2nd 2008
From The Economist print edition

Why it is risky to speak so plainly of impending doom

Illustration by S. Kambayashi

"AND gentlemen in England now a-bed, shall think themselves quite lucky they are not here, because it's going to be extremely scary." Had Henry V issued such a rallying cry before the battle of Agincourt, the English army might not have achieved such a famous victory.

Political leaders have duly chosen to be upbeat in the face of economic and financial calamities, albeit at the risk of historical ridicule. "The fundamental business of the country…is on a sound and prosperous basis," said President Hoover in October 1929 (see article). The reasoning behind such piffle has been that any sign of panic from the nation's leaders would only make matters worse.

So it has been something of a surprise to listen to American authorities in recent weeks. "Our entire economy is in danger," said President Bush on September 24th, adding that "our country could experience a long and painful recession." Of course, the president was trying to urge the passage of the $700 billion bail-out plan and Ben Bernanke, the chairman of the Federal Reserve, explicitly linked failure to pass the plan with a recession.

Nevertheless, this was a risky strategy on two levels. The first was that the plan might not pass (indeed, the House of Representatives voted against it on September 29th,) or that it might pass only in amended, and thus weakened, form. The second was that the mere talk of recession could undermine the confidence of both businesses and consumers and thereby bring about the recession everyone was trying to avoid.

Confidence, or what Keynes called "animal spirits", is vital for economic health. It takes confidence for businesses to hire workers or invest in machinery and equipment; managers need to believe the economy will be strong enough to make such investment justified. It takes confidence for savers to put their money in the bank, on the assumption the bank will be around to return it to them. It takes confidence for consumers to take out loans to buy houses or cars, on the assumption they will be employed long enough to pay the money back.

A lot of that confidence is unthinking. When Northern Rock, the British mortgage lender, was under siege by savers last year, British depositors were shown to be mostly clueless about the limits of the government's compensation scheme.

When that *sang froid* is undermined, the reaction can be swift and severe. One of the reasons for the freezing of the money markets is that one fund "broke the buck"—that is, it failed to repay investors at par. Although investors may have been aware in theory that such a thing was possible, in practice it had happened only once before. There was a mass withdrawal from money-market funds as a result.

What might loom now is a kind of confidence arms race in which governments attempt to ensure their banking system is immune from the global troubles. The Irish decision to guarantee the deposits of its six leading banks may yet, if it attracts a torrent of cross-border depositors, force other governments to follow. Both Britain and America are planning to lift the limits on their deposit-insurance schemes. When it comes to shoring up confidence, actions now speak a lot louder than words.

It does not help that people, particularly in the EU, seem to lack confidence in their own immediate future. This is captured by consumer-sentiment data, although these tend to have a rather tenuous relationship with more concrete measures like retail sales. However, when there is a big gap between consumer sentiment and activity figures, it is the activity data that normally have to catch up, says Leo Doyle, an economist at Dresdner Kleinwort. That bodes ill for sales.

As for business confidence, the problem is that investment is prone to feast and famine. Nothing is more likely to make an executive open his chequebook than seeing a rival doing the same thing. In bad times, no manager wants to be the fool who invested unnecessarily and created too much capacity.

This can lead to companies having excessively high hurdle rates for investment, academics have found. A paper* by Avinash Dixit of Princeton University suggests that investment is lumpy because businessmen are uncertain about the future; the idea of waiting before committing capital to a project has an option value. The more the economic outlook is cloudy, the greater the incentive to wait.

So politicians ought to think twice about spreading despondency. That is the media's job.

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* "Irreversible Investment with Uncertainty and Scale Economies"

Deposit insurance

A useful fiction

Oct 2nd 2008
From The Economist print edition

In deposit insurance we trust. Sort of

IN MAY *The Economist* failed to dispatch a correspondent to Tirana, Albania, to attend the opening function of the third International Deposit Insurance Week. That may have been a mistake. By this week interest in the technicalities of how to protect the cash the public keeps in bank accounts had reached the campaign trail in America. Both presidential candidates, keen to calm a rattled public, proposed lifting the ceiling on deposit insurance from $100,000 to $250,000. This, said Barack Obama, would "help restore public confidence in our financial system". The change was included in the revised bail-out bill Congress is considering. Meanwhile Britain's government said it would raise its scheme's ceiling and other big countries in Europe could follow.

Political faith in deposit insurance is very widely held. Since America's Federal Deposit Insurance Corporation (FDIC) was established in 1933, 98 other countries have embraced it, with Australia alone among big rich countries in offering depositors no explicit safety net if a bank fails. The ceilings vary by country (see chart), as do the funding mechanisms, with some schemes paid for by a levy on financial firms and others by governments. But almost all are justified on two grounds. First, an information asymmetry: Joe Sixpack is even worse than regulators at identifying which banks take foolish risks with depositors' money. Second, if the public is convinced deposits are safe, systemically dangerous bank runs are less likely.

The traditional criticism of insurance is that it may indirectly encourage banks to take more risk. But today, in the midst of a systemic banking crisis, the concern is rather more life-and-death: whether the insurance actually works. For even if a trusted scheme exists, it may still be entirely rational for depositors to shift cash from failing banks.

This sometimes reflects poor design. With Britain's Northern Rock, insured depositors faced months of red tape before getting their money back: better to withdraw it now. But the big problem is that even if the ceilings are set generously, lots of deposits fall outside the safety net. Britain's new limit will still leave about two-fifths of cash on deposit uninsured. America's proposed change would do no more than reduce the part of the deposit base that is unprotected from 38% to 27%. The idea of a quarter or more of a big bank's deposit base being wiped out is politically unthinkable. Indeed when Wachovia, America's fourth-largest commercial bank by assets, was rescued this week, the FDIC created a structure that protected all deposits. It has done so with other banks, too.

One medium-term response would be to remove the ceilings so that all savers, from paupers to princes, were fully guaranteed. But this would push most industry-funded schemes into bankruptcy. Already the FDIC's available funds, including untapped credit lines from the Treasury, are equivalent to just 1.5% of total commercial-bank deposits. Ultimately, if the public thinks multiple failures of big banks are likely, only the government can offer a credible guarantee.

That is just about manageable in big economies: commercial-bank deposits and other liabilities equate to about three-quarters of America's GDP. But it is a potentially damaging burden for some small countries. Tiny Ireland, with its oversize banks, has just augmented its insurance scheme by giving a blanket government guarantee to bank deposits and liabilities. The gross commitment is equivalent to just over twice its GDP. Organisers of next year's International Deposit Insurance Week should probably avoid Dublin.

Economist.com FINANCE & ECONOMICS

Accounting

Fair cop

Oct 2nd 2008
From The Economist print edition

Fair-value accounting becomes a political issue

IN FIRING their bazookas at the crisis, policymakers have blown holes in rules on everything from share trading to competition policy. It is therefore a miracle that fair-value accounting standards have not been hit too, in particular the requirement that banks “mark-to-market” most of their financial assets other than loans. These rules are deeply unpopular with many firms that have suffered losses and impaired capital positions. They would prefer to recognise losses in the traditional way—that is, slowly and when it suits them. More controversially, some argue the rules have created a vicious cycle of forced sales and falling prices.

Now, however, politicians have brought the accounting regime directly into their line of fire. In America the revised bail-out package being considered by Congress would give the Securities and Exchange Commission (SEC), the stockmarket regulator, the power to suspend fair-value rules. Perhaps to pre-empt this, on September 30th, the SEC and the body which it licenses to set the rules, the Financial Accounting Standards Board, issued new guidance on fair value. This appears to make it easier for firms to argue that the market for a given asset is “distressed”. In such circumstances they can put much less emphasis on market prices.

The situation is more complex in Europe and other territories governed by the International Accounting Standards Board (IASB). The SEC is answerable to Congress, but there is no easy legal mechanism by which to turn up the heat on IASB, which is a private body. That has not stopped politicians from trying; Nicolas Sarkozy, the French president, reportedly sent a proposal to the European Commission that recommends suspending fair value, which he argues leaves bank balance-sheets “at the whim of speculators”. The commission may be receptive—Sir David Tweedie, IASB’s chairman, says that it mandated the use of international standards in Europe “with great courage and in total ignorance of the effects of its decision”.

Is it the beginning of the end for fair value? That seems unlikely. Standards setters will resist anything beyond tinkering with the rules. They will be supported by institutional investors and accounting firms. And anyway it now seems unlikely that suspending fair value would make much difference. The credit crunch has moved on, in the words of one banker, “from a mark-to-market phase to a more traditional phase of credit losses”. The recent forced sale of Wachovia, America’s fourth-largest commercial lender, reflected concerns about its loans, which banks almost always carry using historic-cost rules, not fair value. If mark-to-market accounting really does react too fast to the market, politicians may have responded too late.

Rethinking Lehman Brothers

The price of failure

Oct 2nd 2008 | NEW YORK
From The Economist print edition

The government must privately rue its hard line towards Lehman

CONFRONTED by blaze after blaze in recent weeks, America's financial firemen have rushed to douse the flames—with one exception. Unable to persuade any rival to take on a battered Lehman Brothers, the government was left with a hard choice: spray the investment bank with public money or let it burn. In choosing destruction, the government has provided a painful lesson in the dangers of doing the right thing at the wrong time.

In a sense, Lehman's misfortune was not to have hit trouble earlier. After broking the sale of Bear Stearns, another Wall Street firm, and nationalising the country's mortgage agencies, officials felt an example needed to be made so as to combat "moral hazard", or the risk that banks will act recklessly if they know they will be bailed out when their bets sour. Hank Paulson, the treasury secretary, believed Lehman's problems were sufficiently well advertised to have given derivatives markets time to prepare for the worst.

He was partly right: the credit-default swaps market has buckled but not broken. But Lehman's bankruptcy shredded the last remnants of confidence in American International Group, an insurer, and crystallised fears over the stability of the remaining free-standing investment banks, Goldman Sachs and Morgan Stanley. Alarm over "counterparty" risk—the risk of a borrower or trading partner failing to cough up—turned into outright terror, paralysing money markets. "It was the mistake of a lifetime," says one senior bank executive, echoing the view across Wall Street.

Lehman went bust with $613 billion of debt, of which $160 billion was unsecured bonds held by an array of investors around the world, including European pension funds and individuals in Asia who had taken comfort in Lehman's high credit rating. The price of this paper quickly collapsed to 15 cents on the dollar or less, destroying overnight twice as much value as Lehman's shareholders had seen evaporate over several months.

Illustration by David Simonds

These losses set off a spiral in money markets. Investors yanked $400 billion from money-market funds, a supposedly super-safe source of funding, when one fund that had loaded up on Lehman debt suffered

losses. The run was halted by a government pledge to guarantee money funds' par value, but it stripped money funds of all appetite for risk. Their flight into safe government and mortgage-agency paper has left banks and companies struggling to raise working capital.

Had officials foreseen this debacle, Lehman would surely have been propped up. One theory doing the rounds is that they seriously underestimated the money funds' holdings of its debt. As they fretted over Lehman's vast notional exposures in swaps, they may have taken their eye off the potential impact of its failure on more prosaic cash markets.

Taken aback, policymakers now seem unsure how much protection to offer creditors of other basket-cases. When Washington Mutual (WaMu), America's largest savings-and-loan institution, was hurriedly sold to JPMorgan Chase on September 25th, its bondholders lost everything. This infuriated senior debtholders, who felt the seizure deprived them of the chance to recover some of their money through a public liquidation. Wachovia's creditors were spared that fate in the bank's equally rushed sale to Citigroup a few days later. There was some justification for this different treatment: Wachovia has much more short-term debt than WaMu, so wiping out its creditors would have caused a bigger shock. Still, to some, America's bail-out policy looks haphazard.

The full costs of Lehman's failure have yet to be determined, both in terms of the damage to credit markets and the losses inflicted on its creditors and trading partners. Its swap exposures are still being unwound. Recovery values on its bonds could be anything from pennies to more than 30 cents on the dollar. Dozens of hedge funds that used Lehman as a prime broker are fighting for the return of assets. The task is complicated by the fact that the firm used some of these as collateral for its own loans. Its bankruptcy is by far the messiest in American corporate history.

Throughout this crisis, Mr Paulson's Treasury has stressed the importance for the long-term health of the financial system of letting sick financial institutions fail. In highly stressed markets, however, there are short-term costs. In Lehman's case they are proving almost unbearably onerous.

Echoes of the Depression

1929 and all that

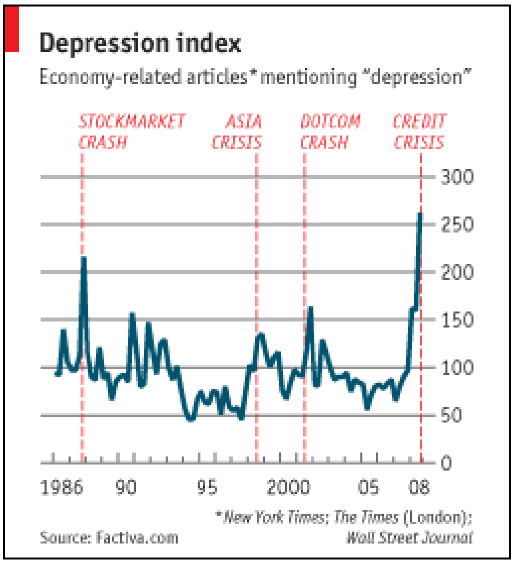
Oct 2nd 2008
From The Economist print edition

How today's financial crisis resembles the one that happened three-quarters of a century ago, and how it does not

EASY credit, some say, was one problem. It was amplified by newfangled, flighty financial techniques, notably buying assets with borrowed money and watching leverage work its arithmetical magic. And underneath it all was a breezy, unthinking optimism, that prices could only ever go up. This was a perfect recipe for a runaway boom—and for a ruinous bust.

Substitute "houses" for "assets" in the paragraph above, and you might be reading a rough description of the blowing-up and bursting of America's property bubble. Insert "shares", and you might be back in the late 1920s. Whereas the fancy financial ideas of the 2000s comprised securitisation, credit-default swaps, collateralised-debt obligations and all their weird cousins, the innovation of choice before the crash of 1929 was the investment trust, a company whose purpose was to speculate in other companies' shares, using the wonders of leverage to multiply the returns (and, in the end, the losses).

In strange territory almost any map will do, no matter how incomplete or out of date. In trying to pick a way through today's financial crisis, there are plenty to pore over. Among them is one drawn in Sweden in the early 1990s, another from Japan in the same decade and an American one from a few years before that. By far the scariest, though, is that sketched in the years beginning in 1929. Frequent reference is made to it (see chart).



But the map of the Depression provides only an incomplete guide to how the American economy got to where it is now. The parallels between the speculative mania that ended in October 1929 and the housing bubble are seductive but misleading. Today's banking and credit-market crisis, and all the damage it may do to the real economy, can be traced to the property boom and subprime bust. In fact, although scholars still rake over the causes of the Depression, few think the 1929 crash contributed much. An economic slowdown was already under way before the stockmarket collapsed. And although loose monetary policy helped pump up the recent property bubble, there is much more debate about its contribution to the 1920s boom.

Where study of the Depression is more helpful, though, is in steering clear of deeper trouble. In the early 1930s deficit finance was a heresy: in 1931, as bank runs were wrecking America's financial system, President Hoover wanted to balance the federal budget, which in those pre-New Deal days was small beer anyway. (He failed.) Monetary policy was also too tight—the main reason, argued Milton Friedman and Anna Schwartz in a brick of a book 45 years ago, why downturn became Depression.

It is no bad thing, then, that as an academic Ben Bernanke studied the Depression in earnest—looking in particular at how an impaired banking system had made the slump longer and deeper. At a conference in 2002, to honour Friedman on his 90th birthday, the chairman of the Federal Reserve (then a governor) addressed him and his co-author. "Regarding the Great Depression," Mr Bernanke said. "You're right. We did it. We're very sorry. But thanks to you, we won't do it again."

A less obvious lesson is that early in the Depression it was not clear how bad things were going to get—or, given the paucity of economic data, even how bad they were. A year after the crash, many Americans thought that they were in the midst of a usual, if painful, downturn—not as bad, surely, as 1921, when the economy contracted by a quarter in a single year. Indeed, rural areas, home to 44% of Americans in

1930, had long been in bad shape: farming had been in a slump since the early 1920s.

But worse was to come. A wave of bank failures broke late in 1930. Another lot followed in 1931: a run on Creditanstalt, an Austrian bank, set off a chain of events that took Britain off the gold standard and raised fears that America might follow. Foreigners and domestic depositors alike demanded gold from American banks. Nor was that the last downward turn. Compare then and now: a year after the credit crisis began last August, America's economy seemed to be standing up well. Today it looks much less secure.

The map's political features also bear examination. Gaps are dangerous—especially between presidencies. Between Franklin Roosevelt's first election victory in November 1932 and his inauguration in March 1933 America's economy spiralled even further down. In February another rash of bank failures broke out. The crisis ended—and the bottom of the slump was reached—only with a federal bank holiday, declared by Roosevelt within days of taking office. Hank Paulson, treasury secretary in 2008, thinks the financial system cannot wait until 2009 for a rescue plan.

The Depression also acts as a warning of the pitfalls of congressional politics. The Bush administration found out all about those this week. There were echoes, perhaps, of 1930. That year yielded the Smoot-Hawley tariff act, the product of a special session of Congress called by Hoover to address the economic troubles. The tariff helped give the world economy a downward shove. A thousand economists wrote to oppose it. (Hoover disliked it too, but chose not to veto it.)

Is 2008 a repeat of 1929 or 1930? Look not at the road ahead but the immediate surroundings, and the question seems absurd. America's economy may be just entering recession; between 1929 and 1933 it shrank by more than a quarter. Some economists fear that unemployment, now a touch over 6%, might reach 10%; in 1933 it was about 25%, and many of those in work were on short time and short pay. Americans are not banging at the doors of banks demanding their money, nor queuing around the block for soup and bread. America is not yet a land of Hoovervilles—or Bushvilles—inhabited by those turfed out of jobs and homes. Nor should it be allowed to become one.

Economics focus

The resilient dollar

Oct 2nd 2008
From The Economist print edition

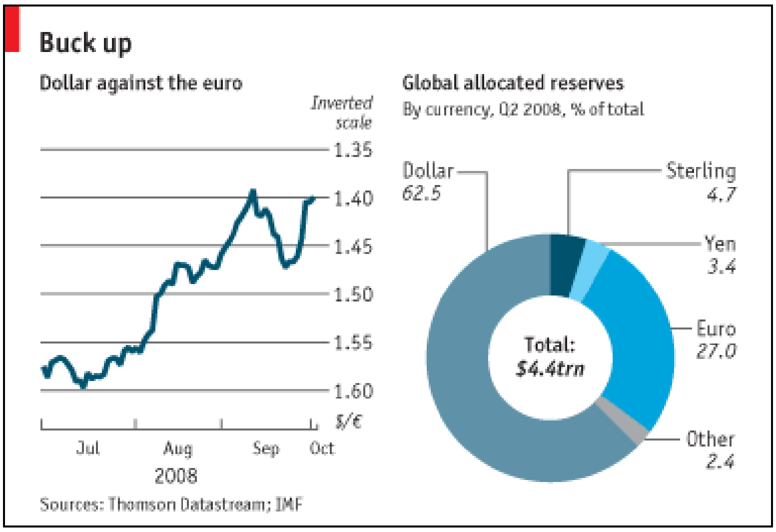
Why the greenback has so far withstood the panic in financial markets

IN BRITAIN, where earnestness is a sin and drollery a virtue, dismay about the global financial crisis is best masked with humour. The British reaction to bank failures is to josh that the best place to store money is under the mattress—or in an Irish bank. When America's $700 billion rescue package stalled in Congress, Willem Buiter, an economics professor, prolific blogger and honorary Brit, joked that his "remaining financial wealth is now kept in a (small) old sock in an undisclosed location."

A worried saver, such as Mr Buiter, shunning banks for the safety of hosiery, still faces a choice about what store of value to use as stocking filler. Gold is for the really scared. Its price has risen by about one-fifth in the space of three weeks. Makers of gold bars are struggling to keep up with demand. Even central banks now seem less keen to swap gold for paper currencies. European ones agreed in 1999 to limit their combined gold sales to 500 tonnes a year. In the 12 months to September, they sold just 343 tonnes, the lowest total since their pact was forged.

Gold tends to do well when the dollar struggles. And there are good reasons to be anxious about the dollar. America depends on foreign savings to finance its large current-account deficit, which was close to 5% of GDP in the second quarter. But the allure of America's financial assets has been tarnished by the shakiness of its banking system. Bail-outs and state guarantees to shore up the system may help, but they also strain public finances and raise concerns that the government may be tempted to inflate away its debts by printing money.

Yet for all these worries, the dollar has come through the recent turmoil surprisingly well. It initially gave up some of the ground it made over the summer but swiftly recovered (see left-hand chart). The persistent foreign demand for American assets is remarkable given all those scares. Last year just over $2 trillion of capital—direct investments in firms or purchases of bonds, equities and other loans—came from investors outside America, mostly private ones. This was more than enough to cover the $730 billion current-account deficit and leave enough over to finance $1.3 trillion of investments by Americans overseas.



In a recent study* Kristin Forbes, of the Massachusetts Institute of Technology, set out to discover what lies behind this hearty appetite for dollar assets. She looked at several factors that might affect the cost and benefits of buying American assets, including each country's capital controls, its financial development, its investment returns at home, and how useful dollar assets were in diversifying risk. Two striking results emerged. First, there was little evidence that foreigners buy American as a hedge against

risks at home. If a country's investment returns moved in tandem with America's, this did not reduce their thirst for dollar assets. This is the opposite of what financial theory predicts—that investors would be keener on foreign assets the less they were correlated with their domestic ones.

The second big result has implications for the dollar and how economists think about global "imbalances", the recent phenomenon of big current-account deficits in rich countries financed by poor-country surpluses. Ms Forbes found that a lack of financial development at home makes foreigners keener to invest in America. What attracts them is the size, liquidity, efficiency and transparency of its financial markets compared with what is on offer in their domestic markets. This finding adds weight to theories which explain global imbalances as a consequence of slow financial progress. In this view, poor countries save hard and buy foreign securities because of a dearth of good options at home.

Once lost, never recovered?

A chunk of these savings are in the form of official currency reserves, and the dollar's status as the global currency may have helped it recently. The greenback accounts for almost two-thirds of official foreign-exchange reserves identified by the IMF (see right-hand chart). In scary times, private investors may well see logic in buying the same currency that central banks hold for a rainy day. But does America's economic travails bring forward the day when the dollar loses its reserve-currency status?

Barry Eichengreen of the University of California, Berkeley, takes a middle view. He argues that the dollar is both safe as a reserve currency and vulnerable to a challenge by the euro. In a recent paper** written with Marc Flandreau, of the Graduate Institute in Geneva, Mr Eichengreen takes issue with the common idea that there is room for only one main reserve currency. The authors compile new estimates for currency-reserve holdings between the two world wars that show that sterling and the dollar vied for supremacy. Indeed the dollar first surpassed the pound as the leading currency in the mid-1920s, far earlier than previously thought. But sterling regained supremacy in the 1930s. So history has mixed lessons for the dollar. The good news is that shifts between reserve currencies take place gradually. Sterling was not, as previously thought, abruptly dethroned by the dollar; the dollar in turn is unlikely to fall from grace suddenly. But history also teaches that reserve-currency status is not a natural monopoly, protected by incumbency and inertia. The euro, says Mr Eichengreen, is a plausible alternative to the dollar.

The euro's capital markets are of comparable depth and liquidity as the dollar's, and the euro-area economy is roughly the same size as America's. Faith in the efficiency of America's financial markets must surely have been shaken by recent events. Yet the banking crisis and its economic fallout is a transatlantic affair. This week's banking bail-outs in Europe are a sign that the old continent is not much safer for foreign investors than America. Worried savers may still find that they still sleep a little easier with dollars under the mattress, rather than euros.

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* "Why Do Foreigners Invest in the United States?" National Bureau of Economic Research (NBER) Working Paper No. 13908 (April 2008).

** "The Rise and Fall of the Dollar, or When Did the Dollar Replace Sterling as the Leading International Currency?" NBER Working Paper No. 14154 (July 2008).

Defining death

O death, when is thy sting?

Oct 2nd 2008
From The Economist print edition

Digital Railroad

Some bioethicists reckon that the definition of death is starting to embrace the living. Indeed, some reckon that it should

IN THE summer of 1968, while youth was redefining itself in Paris, San Francisco and elsewhere, a committee at the Harvard Medical School was busy redefining the end of life. Following its recommendations, almost all rich countries adopted a definition of death based on the extinction of activity in the brain, rather than in the heart or any other organ. In some places, notably America, that means monitoring the brain's electrical chatter to make sure the whole organ has died. In others, such as Britain, the brain's stem is regarded as the crucial part. In this case simpler tests can be applied, such as whether a patient's pupils react to light. Either criterion, however, seems more reasonable than just registering a pulse, since it is the brain, not the heart, that makes the individual.

At the time, there were some objections to the change on religious grounds. But the western world's most organised religion, the Catholic church, did not object. It asked only for moral certainty that death applied to the whole being, and left the judgment of when that happened to the experts with the encephalograms. Forty years on, however, those experts are divided, and the church is under growing pressure to reject criteria based on brain death, and return to the alleged unambiguity of permanent cardiac arrest.

The debate has flared up ahead of a conference on organ donation that will be held in the Vatican in November. One of the triggers was an article in the Vatican's newspaper, *L'Osservatore Romano*, by Lucetta Scaraffia, a religious historian at La Sapienza University in Rome and a member of Italy's National Bioethics Committee. What worries Dr Scaraffia is that, as the demand for organs rises, doctors are under pressure to shift the line that divides life from death, so that they can get hold of organs for transplant at a time when they are more likely to be in a healthy condition.

One of the aims of the organisers of the conference, who include the Pontifical Academy for Life, which ponders these matters on behalf of the world's Catholics, is to discuss "the importance of spreading the culture of organ donation". Dr Scaraffia, however, believes the church is jumping the gun. First, she says, it must address the more difficult question of when a person can really be said to be dead. And other doctors, though not necessarily opposed to moving the line, agree the matter needs to be cleared up.

I'm not dead yet!

In August, for example, Robert Truog of the Harvard Medical School and Franklin Miller of America's National Institutes of Health, bioethicists both, published a paper in the *New England Journal of Medicine* describing a recent trend to revert to using cardiac death as the critical marker. But that is not good news for Dr Scaraffia and her followers for, according to Dr Truog and Dr Miller, the definition of cardiac death has changed over the years in just the sort of way that Dr Scaraffia predicted that it might.

Dr Truog and Dr Miller posit the example of a patient who has given informed consent to the withdrawal of life support in the case of his suffering devastating brain injury. The doctors respect his wishes and his heart stops beating. So far, so ethical. But instead of waiting a few minutes for his brain to die as well, they anticipate this inevitability and declare him dead immediately, so that they can hurry along with the business of removing his organs.

Death in such cases is therefore based on a decision not to resuscitate, not the impossibility of resuscitation. And their hypothetical case does seem to be happening more frequently in reality. In America, data from the Organ Procurement and Transplantation Network, an organisation that matches donors to recipients, show that those classified as cardiac-dead but not brain-dead represent the fastest growing proportion of donors, having risen from zero ten years ago to 7% in 2006.

Dr Truog and Dr Miller reckon this gerrymandering of the division between life and death will continue as long as doctors have to abide by the dead-donor rule—that although a living person can consent to have a non-vital organ removed for transplant (a single kidney, for example) vital organs can be removed only from dead bodies. Instead, they propose that someone whose brain is devastatingly and irreversibly damaged, and who has previously given his informed consent, should be able to donate vital organs while still alive.

In practice, says Dr Truog, this would not differ much from what happens now, except that doctors would be released from the temptation to fudge the definition of death, or to accelerate it by, for example, withdrawing life-sustaining treatment. Indeed, the British government is considering changing the regulations in a way that would allow just that to happen.

The prospect of having their vital organs removed while they are still alive might put some people off carrying donor cards altogether, Dr Truog admits, so the plan would have to be accompanied by a public-education programme about what irreversible brain injury means. Nevertheless, his views have alarmed some people, including delegates to the forthcoming Vatican debate.

Antonio Spagnolo, a bioethicist at the University of Macerata, Italy, and an expert on the Catholic view of death, says that to violate the dead-donor rule would be to violate the primary duty of a doctor, which is not to inflict harm. The definition of death may have to evolve as science advances, Dr Spagnolo says, but doctors must continue to declare it based on "humanly reasonable certitude", and with no ulterior motive—a task, it may be noted, that once went to the priests.

Private spaceflight

Saint Anselmo's Fire

Oct 2nd 2008 | GLASGOW
From The Economist print edition

Some more steps towards the commercialisation of space travel

AFP

What's your burn rate?

IF ANYONE were ever canonised as patron saint of the privatisation of spaceflight, Rene Anselmo would be a leading candidate. Anselmo, who died in 1995, shattered the international government monopoly on satellite communications that existed in the 1980s by founding PanAmSat. Anselmo's oft-repeated motto was "truth and technology will triumph over bullshit and bureaucracy". A graphic illustration of what he thought of government involvement in space could be found in the logo on the side of the rockets that launched his satellites. It was of a cartoon dog raising its leg, as if to a lamp-post.

This attitude resembles that of a new wave of pioneers in the space industry. Burt Rutan, the inventor of *SpaceShipOne*, Elon Musk, the boss of SpaceX, and Sir Richard Branson, the chairman of the group of companies that owns Virgin Galactic, each seek to privatise the business of transporting goods and people into space. One of their reasons is that the governments of America, Europe and Russia have failed over the past five decades either to reduce the costs of getting there or to improve the reliability and availability of spaceships. So it is pleasing to note that truth and technology had a few victories over the other stuff this week.

On September 28th, SpaceX launched (admittedly at the fourth attempt) its Falcon 1 rocket into orbit. Falcon 1 is the first privately developed liquid-fuel rocket to get there, and at less than $10m it costs half as much as the cheapest existing equivalent. That, Mr Musk hopes, will change the economics of launching small satellites.

This is good news for GeoOptics of Pasadena, California. The firm plans to commercialise the routine observation of the Earth from space. It is raising money for a project to launch 24 satellites that weigh 30kg each. Such small payloads could be sent up a dozen at a time on a Falcon 1.

In the longer term, besides launching lots of satellites, Mr Musk seeks to develop a new family of space launchers based on Falcon 1 that will reduce the cost and increase the reliability of spaceflight by a factor of ten. SpaceX's programme includes being able to deliver cargo and crew to the International Space Station by 2010.

Virgin Galactic also had news. At the International Astronautical Congress in Glasgow it announced a new line of work for its suborbital vehicles. Later this year it is to start flying experiments for America's National Oceanic and Atmospheric Administration (NOAA). Although, strictly speaking, Virgin Galactic is not breaking any government monopoly in the suborbital area, since other firms already fly unmanned vehicles this way, its aim is to overhaul the field by operating more frequent services at lower cost. Its two vehicles, an aeroplane and a rocket, are primarily intended to take tourists to an altitude of 110km (69 miles), which counts as outer space. But the venture also opens other commercial avenues, such as astronaut training and (as the arrangement with NOAA shows) the carriage of scientific experiments to the edge of the atmosphere.

The agency's aim is to collect data on the distribution in the upper atmosphere of climate-affecting gases. This will help to test computer models of the climate and to calibrate the data sent back by the *Orbiting Carbon Observatory*, a satellite due to be launched next year by NASA, America's space agency. One of NOAA's plans is to use Virgin's launch aircraft to carry what it calls an AirCore. This is a tube about 150 metres long that is open at one end and closed at the other. It will be dropped from high altitude in order to collect a column of air in a way similar to that in which a column of ice is collected by an ice corer.

Unfortunately, due to the eccentricity of American government regulations on the testing of experimental spacecraft, Virgin Galactic cannot receive any short-term payment from NOAA for its work. But the publicity should help the firm and it is also hoping for a long-term collaboration that would, eventually, yield some revenue.

Whether Anselmo would have approved of such a taxpayer-financed approach, albeit at one remove, is moot. But you have to start somewhere.

Conservation

Where the wild things are

Oct 2nd 2008
From The Economist print edition

A new database will warn companies if their activities threaten rare species

LAKE BAIKAL holds a fifth of the world's unfrozen fresh water. It is home to thousands of species of plants and animals that are found nowhere else. Its northern shores, as anyone using the Integrated Biodiversity Assessment Tool (IBAT), a new online database, can easily discover, form part of a World Heritage site. There are also several Russian national parks and reserves in the area. Four species of birds considered "vulnerable" by conservationists, including the greater spotted eagle and the lesser white-fronted goose, can be found in a local wetland. The "critically endangered" Siberian crane flies through on the way to its summer nesting grounds.

If Transneft, a Russian firm that first proposed a few years ago to build an oil pipeline through the Baikal region, had been able to see all this information—including detailed maps of especially biodiverse spots and the threatened species that inhabit them—at the click of a mouse then it might have altered its plans and avoided those spots. This would have spared it some of the $1 billion that it claims shifting the pipeline's route, as it has agreed to do after persistent protests, will cost.

That, at any rate, is the sort of thing Conservation International, the charity that conceived IBAT, had in mind when it decided to bring together as much data on biodiversity as it could in a single database, to be unveiled at the forthcoming World Conservation Congress in Barcelona. Big oil and agro-industrial firms such as BP and Cargill helped with the design, as did several banks. The idea is to make it easier for businesses to incorporate concerns about conservation into their planning from the beginning of a project, and not simply when protesters show up at their offices.

Many conservation groups compile information about biodiversity in one form or another. The International Union for Conservation of Nature (IUCN), the organiser of the meeting in Barcelona, maintains a list of national parks and other protected areas in conjunction with the United Nations Environment Programme. The IUCN also produces the often-quoted "Red List" of species at risk (the source of labels such as "vulnerable" and "critically endangered"). And the IUCN, Conservation International, BirdLife International and various other such organisations have long been collaborating on a systematic assessment of the well-being of as many different species as possible. They have already worked their way through birds and amphibians, and have started looking at reptiles, corals, mangroves and sharks. They will reveal their findings on mammals at the conference, along with updated versions of both the Red List and the database on protected areas.

The World Bank, for one, has guidelines that require borrowers to protect biodiversity. By the same token, many commercial banks have signed up to the Equator Principles, a set of ethical rules for bankers that enshrine respect for conservation. But consulting the many different lists and databases can be a chore for firms—especially smaller ones without whole departments devoted to environmental propriety. Moreover, many of them are reluctant to share their plans with conservation groups until they are quite advanced, for fear of giving away commercial secrets and stirring up opposition. Anyway, most conservation groups do not have the capacity to answer endless inquiries from anxious firms.

IBAT, however, brings lots of information together in a single, accessible source. Better still, it is anonymous. Firms will have to register to use it, but no records will be kept of what they look up. BP, for example, says it could use IBAT to check whether areas where it might bid for exploration licences are ecologically sensitive, without alerting competitors to its interest. It also thinks IBAT could come in handy when planning the routes of pipelines.

Dating earthquakes

Written in stone

Oct 2nd 2008
From The Economist print edition

A new way of detecting ancient earthquakes

ON DECEMBER 16th 1811, the residents of New Madrid, Missouri, were startled out of their beds by a huge earthquake, which was quickly followed by a second. Those who survived the catastrophe reported that cracks opened in the earth's surface, that the ground rolled visibly in waves and that large areas of land sank downwards. The crew of the *New Orleans*, the first steamboat to ply the Mississippi, told locals that they had moored on an island the evening before the earthquake only to discover that it was gone in the morning. People in places as far away as Boston declared that they heard church bells ringing at the time the earthquake happened.

That huge earthquakes occur in parts of North America outside their traditional habitat on the Pacific margin is well known from accounts like those from New Madrid. Such records, however, have been kept only since Europeans arrived, so it has been hard to work out how active the faults that cause them are. Now it is a little easier. A study carried out by Samuel Panno of the Illinois State Geological Survey and his colleagues has revealed that nearby caves store the dates of past earthquakes in stone.

Dr Panno and his team found their recording angel in the form of stalagmites, the conical projections that grow on the floors of limestone caves. (The structures that hang down above them are called stalactites.) They made their discovery when they were using a radioactive dating technique to check the ages of small stalagmites occupying a number of caves in the Midwest. Many of these stalagmites, they found, had come into existence at about the same moment, and that moment coincided with the New Madrid earthquake.

This makes sense. Stalagmites form when water trickles through crevices in a cave's ceiling and drips to the floor. Each drop carries with it a quantity of dissolved calcium carbonate (the defining ingredient of limestone) that it has picked up while flowing through the rock above. When a drop lands, some of this mineral is deposited at the landing site, where it accumulates, forming a stalagmite. A paper to be presented at a meeting of the Geological Society of America in Houston on October 5th by Dr Panno's colleague Keith Hackley suggests that when large earthquakes shake the ground, new cracks in cave ceilings open. The result is the formation of a new generation of stalagmites.

Like trees, stalagmites are often composed of concentric layers that represent annual growth periods. Counting the layers is one way of assessing how old a stalagmite is. But radioactive dating provides a second, and sometimes more accurate, assessment. In this case the geologists drilled into the stalagmites and estimated their age from the way that uranium decays into an isotope of thorium. Many, they found, dated back to 1811, while others began life in 1917, the date of another nearby earthquake.

Subsequent investigation has confirmed a further seven big earthquakes previously suspected to have happened over the course of the past 18,000 years. An average interval between quakes of 2,500 years is a hopeful sign for New Madrid's immediate future. But if the technique can be tried out in other places it might reveal areas now thought safe, precisely because there has not been a recent earthquake, that are actually under threat.

Chinese capitalism

The long march backwards

Oct 2nd 2008
From The Economist print edition

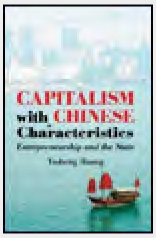
eyevine

A surprising new book argues that China is becoming less, not more, of a capitalist economy

MOST people, particularly those living outside China, assume that the country's phenomenal growth and increasing global heft are based on a steady, if not always smooth, transition to capitalism. Thirty years of reforms have freed the economy and it can be only a matter of time until the politics follows.

This gradualist view is wrong, according to an important new book by Yasheng Huang, a professor at Massachusetts Institute of Technology. Original research on China is rare, largely because statistics, though plentiful, are notoriously unreliable. Mr Huang has gone far beyond the superficial data on gross domestic product (GDP) and foreign direct investment that satisfy most researchers. Instead, he has unearthed thousands of long-forgotten pages of memoranda and policy documents issued by bank chairmen, businessmen and state officials. In the process he has discovered two Chinas: one, from not so long ago, vibrant, entrepreneurial and rural; the other, today's China, urban and controlled by the state.

Capitalism with Chinese Characteristics: Entrepreneurship and the State
By Yasheng Huang



Cambridge University Press; 368 pages; $30 and £15.99

Buy it at
Amazon.com
Amazon.co.uk

In the 1980s rural China was in the ascendancy. Peasants, far from being tied to the land, as has been assumed, were free to set up manufacturing, distribution and service businesses and these were allowed to retain profits, pay dividends, issue share capital and even a form of stock option. State banks rushed to provide the finance. Nian Guangjiu, a farmer from impoverished Anhui province, built up a business selling sunflower seeds (a popular snack), employed over 100 people and made a million yuan (nearly $300,000) in profit in 1986—just a decade after Mao's death. Because most of this activity was set up under the misleading label of "Township and Village Enterprises", Western academics largely failed to spot that these ostensibly collective businesses were, in fact, private.

But then, in 1989, came the Tiananmen Square protests. A generation of policymakers who had grown up in the countryside, led by Zhao Ziyang, were swept away by city boys, notably the president, Jiang Zemin, and Zhu Rongji, his premier. Both men hailed from Shanghai and it was the "Shanghai model" that dominated the 1990s: rapid urban development that favoured massive state-owned enterprises and big foreign multinational companies. The countryside suffered. Indigenous entrepreneurs were starved of

funds and strangled with red tape. Like many small, private businessmen, Mr Nian was arrested and his firm shut down.

True, China's cities sprouted gleaming skyscrapers, foreign investment exploded and GDP continued to grow. But it was at a huge cost. As the state reversed course, taxing the countryside to finance urban development, growth in average household income and poverty eradication slowed while income differences and social tensions widened. Rural schools and hospitals were closed, with the result that between 2000 and 2005 the number of illiterate adults increased by 30m. According to Mr Huang, the worst weaknesses of China's state-led capitalism—a reliance on creaking state companies rather than more efficient private ones, a weak financial sector, pollution and rampant corruption—are increasingly distorting the economy.

But what about the growing cohort of Chinese companies starting to strut the world stage? Surely that is evidence of a healthy and expanding private economy. Mr Huang's evidence shows that, on closer inspection, these firms are either not really Chinese or not really private. Lenovo, a computer group, has succeeded because it was controlled, financed and run not from mainland China but from Hong Kong (a happy legacy of the founder's family connections there—not something enjoyed by most Chinese businessmen). The subsidiaries of Haier, a white-goods maker, were also put out of reach of mainland bureaucrats early on. Wahaha, a food producer, Galanz, a maker of microwave ovens, and many others all depended on foreign protection and capital to grow and escape state strictures.

Indeed one of the main, and underappreciated, functions of foreign investment in China has been to play venture capitalist to domestic entrepreneurs. As for Huawei, a telecoms group and one of China's much vaunted "global" companies, its structure and links to the state are so convoluted that the most diligent China-watchers have little idea if it is a private or state firm. They do, however, agree that Huawei's opacity is a microcosm of China's distorted economy.

Could China genuinely embrace entrepreneurial capitalism again, as it did in the 1980s? Its current leaders under President Hu Jintao, who cut his teeth in Guizhou and Tibet, two of the poorest and most rural provinces, talk about supporting the countryside and reducing social inequality. But nothing much has been done. China's deep problems demand institutional and political reform. Sadly, as Beijing's heavy-handed control of the Olympics suggests, there is scant hope of that.

Capitalism with Chinese Characteristics: Entrepreneurship and the State.
By Yasheng Huang.
Cambridge University Press; 368 pages; $30 and £15.99

The second world war

Victory designed by committee

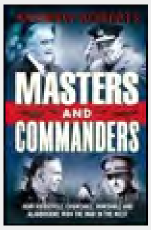
Oct 2nd 2008
From The Economist print edition

ONE of the many virtues of Andrew Roberts's new history of grand strategy during the second world war is to vindicate that much maligned British way of doing things: the committee. The author employs a vast range of contemporary diaries—as well as newly discovered verbatim accounts of cabinet meetings which reveal what was not in the official minutes—to reconstruct the marathon meetings which, no less than the allies' prodigious resources, ultimately determined the difference between victory and defeat.

Historians of Germany will be struck that there was no equivalent process in Hitler's headquarters, where every bad idea went unchallenged by generals who knew better but were cowed by a splenetic maniac. Perhaps that bureaucratic deficit explains why Germany's otherwise superior fighting men (a point Winston Churchill repeatedly acknowledged in private) were defeated by an enemy that was slow to acquire equivalent ferocity and tenacity?

Writing with clarity and elegance, Mr Roberts conveys how his four principals—Franklin Roosevelt, Churchill, General George Marshall and Field-Marshal Alan Brooke (later made Viscount Alanbrooke)—and their armies of aides and staff officers thrashed out the formulae for victory. What was determined by these weary men in rooms rank with cigarette, cigar or pipe smoke, directly affected millions of lives—which Marshall, America's supreme commander, insisted were figuratively present in the shape of daily colour-coded casualty briefings.

Masters and Commanders: How Roosevelt, Churchill, Marshall and Alanbrooke Won the War in the West
By Andrew Roberts



Allen Lane; 720 pages; £25. To be published in America by HarperCollins in the spring

Their decisions included whether to lunge directly at the dark heart of the Third Reich across northern Europe, and whether to attempt this in 1943 or a year later. Or, as the British favoured, to strike around the soft Mediterranean underbelly, so as to draw substantial German forces southward, a decision that led to vicious fighting in central Italy. There were also crucial questions of personnel, with both Marshall and his British colleague, Brooke, turning down commands so that they could continue to control the amateur strategists they worked for. It was exhausting, thankless work, which saw a number of senior figures go prematurely to their graves, a statue being their reward.

One of several moments of high amusement in the book is Marshall quizzing Churchill about Warren Hastings, Rudolf Hess and the abdication crisis on a plane trip, so as to forestall the prime minister's inquiries about what would happen after the allies had taken Sicily. Of his principals, Mr Roberts's favourite is Brooke, the scion of a dynasty of Ulster warriors, whose exasperation with Churchill's *modus operandi* litters his diaries.

Power perceptibly shifts in the book towards the Americans and Russians. At the start of the war—which means late 1941 for the United States—the Americans were regularly ambushed by their better-organised and prepared British partner. But they were quick learners who knew how to capitalise on their vastly superior manpower and material resources. The Russian advance towards Berlin meant that Roosevelt increasingly focused on the cautious enigma in the Kremlin, scarcely bothering to conceal his impatience with the febrile Churchill. This is an important book which, in its layered references to Waterloo, the Crimea and the Somme, sees Mr Roberts lay claim to the title of Britain's finest contemporary military historian.

Masters and Commanders: How Roosevelt, Churchill, Marshall and Alanbrooke Won the War in the West.
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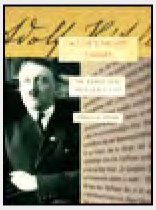
Allen Lane; 720 pages; £25. To be published in America by HarperCollins in the spring

Adolf Hitler

Know a man by his books

Oct 2nd 2008
From The Economist print edition

Hitler's Private Library: The Books That Shaped his Life
By Timothy W. Ryback



Knopf; 304 pages; $25. To be published in Britain by The Bodley Head in February

HE WAS better known for burning books than reading them. But surviving portions of Hitler's private library reveal the German dictator as an ardent bibliophile, owning classics, history, travel writing, biography, studies of the occult and much else.

Timothy Ryback's main find is the portion of Hitler's huge book collection that ended up in an obscure section of the Library of Congress. Other books emerged from American officers who took them as souvenirs. The Soviet army had the best pickings: the library in Berlin's *Reichskanzlei*, 10,000 volumes, was shipped off to Moscow in 1945 and has not been seen in public since (tantalisingly, it surfaced in the 1990s in an abandoned church but disappeared again).

But there is enough to go on. The author neatly weaves together Hitler's political career with his book-collecting habits, tracing the well-thumbed volumes that Hitler consulted during the writing of "Mein Kampf". Mr Ryback's knowledge of German literature and the politics of the Nazi era makes him well placed to follow clues and draw inferences, both from the time and place of acquisition and from the marginalia that can be found in the books. Hitler was not only an avid reader but also an inveterate underliner. Perhaps the most chilling example of that is in Paul de Lagarde's "German Essays". Underlined is: "Each and every irksome Jew is a serious affront to the authenticity and veracity of our German identity."

As the author points out, Hitler had a magpie mind. He speed-read books looking for material that he counted as useful—meaning anything that fitted into his mosaic of misplaced historical analogy and pseudoscience. What didn't fit was discarded. This, as Mr Ryback writes, was the essence of Hitler: "Not a profound, unfathomable distillation of the philosophies of Schopenhauer or Nietzsche, but instead a dime-store theory cobbled together from cheap tendentious paperbacks and esoteric hardcovers, which gave rise to a thin, calculating, bullying mendacity."

Mr Ryback has done a good job maintaining a balance between dispassionate inquiry and moral revulsion. Yet the result is still slightly creepy. Flicking through a copy of what is probably the earliest acquisition in the collection, an architectural history of Berlin that Hitler bought in November 1915, he discovers between pages 160 and 161, "a wiry inch-long black hair that appears to be from a moustache". It is suddenly all a bit too close for comfort.

Hitler's Private Library: The Books That Shaped his Life.
By Timothy W. Ryback.
Knopf; 304 pages; $25. To be published in Britain by The Bodley Head in February

Defending America

The essential nation

Oct 2nd 2008
From The Economist print edition

WHATEVER you think of George Bush, he has created a lot of work for those who, like this newspaper, believe that America can still be a force for great good despite the terrible errors of his presidency. With just over 100 days of that presidency to go, this is an opportune time for Justin Webb and Bronwen Maddox, respectively of the BBC and the *Times*, to remind the world that America and its current president are not the same thing.

In many ways the two volumes, both of them quick and enjoyable reads, could hardly be more different. Mr Webb, as befits a television news reporter, writes very much as he speaks, in a slangy and light-hearted tone that will irritate some people. Ms Maddox is careful and scholarly, much like one of her commentary columns. But the analysis the two journalists offer is broadly similar: those who hate America do so because they concentrate on the worst and blind themselves to the country's great power to correct itself, not to mention the dynamism and opportunity that continue to draw people to it from all over the world.

Mr Webb's book is on the broader canvas. He looks at politics, religion, race, guns, sex, geography and much else. The book is full of pleasing anecdote, but he makes some hefty points as well. He loves America's unique ability to absorb people and make them proud Americans rather than isolating them in their ghettos as Europeans so often do.

He sticks up for the values of modernity that are so often ignored when junk food and TV are sneered at. Western modernity, he says, "allows my children to survive diseases that would have killed them only decades ago. It creates educational opportunities their ancestors never had; opportunities for leisure and fun and fulfilment." He even manages to find some good in the horrors of Guantánamo and Abu Ghraib, pointing to the slow-gathering, huge reaction against the administration's policies that has seen the nomination of two candidates both of whom are implacably opposed to torture.

Ms Maddox's book concentrates on America's role in the world: on NATO, Afghanistan, Iraq, Pakistan, greenhouse gases and other serious matters. She is a much more critical friend to America than is the perky Mr Webb. Some of her chapter headings say it all: "Arrogant but not lawless"; "The Iraq invasion: stupid but not malign"; "The indefensible: Guantánamo and torture". There is plenty about America that she refuses to condone: on global warming, for instance, she notes that it would be wrong to blame American intransigence on Mr Bush since it started, thanks to Congress, under Bill Clinton. Her final judgment is positive: "Be careful what you wish for", she warns those who would like to see America "back in its box". Who else, she says, can stand up to a "belligerent and delusional" Russia? Who else could work on China to obey the international rules? America, Ms Maddox's book concludes, is still the essential nation.

Have a Nice Day: Behind the Clichés—Giving America Another Chance.
By Justin Webb.
Short Books; 240 pages; £14.99

In Defense of America.
By Bronwen Maddox.
Little, Brown; 240 pages; $16.99. Duckworth; £12.99

Have a Nice Day: Behind the Clichés—Giving America Another Chance
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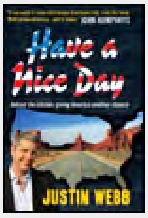

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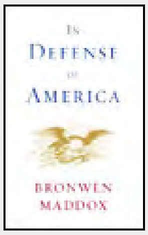

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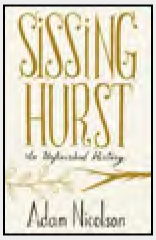
British countryside

A happy return to manure

Oct 2nd 2008
From The Economist print edition

READERS of Adam Nicolson's "Earls of Paradise" about Wilton House in Wiltshire will know how passionately he cares about landscape, or rather about the land. "Landscape" suggests something pictorial. Mr Nicolson is not interested in pictures. For him, beauty is a by-product of the way a landscape works and is worked. The view from the window is dynamic: an organism, a cycle, the antithesis of scenery.

Sissinghurst: An Unfinished History
By Adam Nicolson



Harper Press; 342 pages; £20

His new book is about all these things at Sissinghurst in Kent, the Elizabethan castle where his grandmother, Vita Sackville-West, created her famous garden in the 1930s. After her death in 1962, her son Nigel escaped death duties by giving the whole estate—castle and garden, with mixed livestock and arable farm—to the National Trust (a conservation charity), devoting the rest of his life to promoting the place as a shrine to his parents.

He was on to a winner. The garden, lovely in itself, carried the allure of Vita's aristo-lesbian-Bloomsbury circle, attracting people from all over the world. In 1991, visitor numbers hit 197,000, a damaging peak from which the Trust deliberately retreated. But by then a vital pulse had stopped. The old mixed farm had died. The orchard had been grubbed up for a car park; the granary was The Granary Restaurant, the woodshed a shop and so on. Chickens, pigs, cattle, sheep and their fertilising dung had gone. The now chemically fertilised, monocultural fields were let out to four agricultural businesses. Sissinghurst, turnover £2m, had become, as Mr Nicolson puts it, a "Titian in a car park".

After Nigel Nicolson's death in 2004, his son, Adam, came to live there with his wife and their children. The place was in his bones: "It is an article of faith with me", he writes, "that a place consists of everything that has happened there; it is a reservoir of memories." But he is keen to distinguish this from nostalgia; the sense of oldness and newness being contemporaneous runs through the book. Chapters on his family lead him back and forth between his plans for the future and the history of the castle and the Kentish Weald.

The farm was where the break between old and new was worst. Mending it meant going back, not to reconstruct history but to pick up the thread. He writes unsentimentally and with a poet's eye about all the multifarious work of the old farm: the jostle of the cattle, the ash-gold hops in the oast houses. But in the end, the thread he was looking for was dead simple: lunch. Sissinghurst serves 115,000 lunches every year. He decided to persuade the National Trust that its tidied up gem could grow the food as well as cook it.

The Nicolson's dealings, father and son, with the National Trust make some of the funniest and most painful passages in the book: Nigel's tears when the Trust felled a wood without telling him; Adam receiving curious instructions to park his car with the exhaust pointing west. His scheme, he knew, was deeply resented. It was, he says, like "trying to push a fat clay-mucky lump of otherness into the neat and productive workings of a clock". But he got his way in the end. The farm is there, the cycle is renewed and dung is back at Sissinghurst.

Sissinghurst: An Unfinished History.
By Adam Nicolson.
Harper Press; 342 pages; £20

Saudi Arabia

Right royal

Oct 2nd 2008
From The Economist print edition

THE Saudi kings have been a mixed bunch, ranging from the savvy to the dissolute. But by common consent the one who set his country on the road to modernity was Faisal, who reigned from 1964 until his assassination by a nephew in 1975. It was Faisal who created a bureaucracy, organised the oil industry and launched a development plan that included the radical innovation of schools for girls.

Faysal: Saudi Arabia's King for All Seasons
By Joseph A. Kéchichian

University Press of Florida; 312 pages; $34 and £24.50

Buy it at
Amazon.com
Amazon.co.uk

Joseph Kéchichian is an American scholar of Lebanese-Armenian descent. Though no stylist, he knows Arabia and its princes well. His portrait does not dwell on Faisal the man—the frugal figure who lived in a modest house, drove himself to the office and displayed an almost puritan disdain for princely profligacy—but on Faisal the policy practitioner. Hence two episodes dominate the story.

The first is Saudi Arabia's bitter quarrel with Nasser's Egypt, in particular over the civil war in Yemen, in which they took opposing sides. The second is the crucial period of 1973-74, when the habitually cautious king threw in his lot with Egypt and Syria as they launched their war on Israel, in the full knowledge that this would severely strain his ties with America. The war and the subsequent oil embargo brought to the Middle East a reluctant secretary of state, Henry Kissinger, whose relations with Faisal were less than cordial.

Mr Kéchichian does not gloss over the rifts within the House of Saud which accompanied Faisal's ascent to the throne. Only when the family and the *ulema* (religious establishment) finally lost patience with his spendthrift brother, King Saud, did Faisal replace him. His task was to restore unity to the family, order to the kingdom's finances and consistency to policymaking. The author also deals candidly with internal unrest, in particular the coup attempts by air-force officers and others inspired by Nasser's pan-Arabist gospel.

But in other respects the book verges on hagiography. Faisal may indeed have been a wise leader with a noble vision, but Mr Kéchichian is rather too fulsome in saying so. Moreover he states categorically that Faisal was not an anti-Semite, despite the testimony of Mr Kissinger and others who were obliged to sit through royal rants about the communist-Jewish conspiracy. For those left hungry for more, a biography of Faisal by a Russian Arabist, Alexei Vassiliev, is due out next year.

Faysal: Saudi Arabia's King for All Seasons.
By Joseph A. Kéchichian.
University Press of Florida; 312 pages; $34 and £24.50

Economist.com BOOKS & ARTS

Contemporary sculpture

Serra firma

Oct 3rd 2008
From The Economist print edition

Richard Serra shows off his rings of steel

Lorenz Kienzle

IT WAS in Borromini's church, San Carlo alle Quattro Fontane, in Rome that Richard Serra first saw the light a decade ago. "I was standing in a side aisle, looking at the oval space on the floor and the same oval on the ceiling, called a Borromini ellipse. I thought they were at right angles to each other. When I moved to the central aisle, I realised I was wrong. But I kept on wondering: how can I create—how can I actually make—my misrepresentation?"

Whether it is his drawings (made with melted paintsticks), his famous Torqued Ellipses or the Torqued Toruses described above, the quest to change procedure and make something unforeseen has been at the heart of much of what the 69-year-old American artist has done. In his early years Mr Serra preferred not to work in steel, which he had known from the second world war when his father worked as a pipefitter in a shipyard. "It was the most traditional material of the 20th century." Only, he says, when he was able to imagine using steel's weight, gravity, mass, cantilever and balance did its potential in art begin to interest him.

After his 40-year retrospective at the Museum of Modern Art (MOMA) in New York last year and a highly acclaimed installation at the Grand Palais in Paris this summer (visited, to Mr Serra's amazement, by the president, Nicolas Sarkozy), the sculptor has now brought his magnificent metals to London. Dressed all in black and wearing MBT trainers to relieve the pain from an old back injury, he has spent days overseeing the complex installation.

His three new pieces seem to burst out of the white spaces of Larry Gagosian's gallery near King's Cross station (where they will be on show until December 20th). The first work that greets the visitor is two Torqued Toruses. These are technical words to describe the form wrought from the metal, though the names do little to bring to life the response evoked by actually standing within these soaring shapes. Taller than the versions Mr Serra made for the MOMA show, as well as more elongated—("I wanted to make them better," he says)—these works are at once secretive, magic and forbidding.

The long slab of steel—with weatherproofing so coated and coloured it resembles a giant painting—that dominates the side room is more disconcerting. Though there is room to walk round it, the piece is so strong that it seems to divide the room in two so that the viewer is never certain what is happening on the other side. The sculpture is named after Fernando Pessoa, a Portuguese poet, whose musings about "dream ships" and the scale of human ambition inspired the work.

Pessoa's words provide a link to the third piece in the show, "Open Ended" (pictured above), which is the resolution of the challenge Mr Serra set himself in Borromini's church in Rome. Two ellipses in soaring steel have been set one within the other. The visitor, making his entry at the narrow end of the oval, feels at first as though he is walking in a slanted corridor. By the time he reaches the other end and looks back, he feels more as if he were standing on a dock gazing up at the prow of a huge ocean-going vessel, perhaps one of Pessoa's dream ships. If he walks on a bit farther, this time towards the middle of the work, the sense of what surrounds him changes again to give the feeling of being inside a maze.

There was a time when an emotional response to abstract sculpture was still so new it sharply divided those who came upon it. That it now seems normal is a measure of how far once-radical work, such as this, has been accepted as mainstream. But Mr Serra, famously driven, takes no time to rest.

Between trips to London and his foundry in Germany, he is building a piece for Norman Foster's garden

near Geneva and discussing the possibility of building something for the courtyard of the Prado in Madrid. He explains what is at the heart of his Borromini inspiration: “As the piece rises in elevation, it not only leans in but torques and turns outward. The radius never changes.” And then he adds proudly. “That’s never been done before in the history of form-making.”

Economist.com PEOPLE OBITUARY

Paul Newman

Oct 2nd 2008
From The Economist print edition

Getty Images

Paul Newman, actor and philanthropist, died on September 27th, aged 83

THE eyes were blue. Cornflower blue, steel blue, ice blue. They smouldered through the soft-focus foliage in “Butch Cassidy and the Sundance Kid” as he swayed on a bicycle with Katharine Ross on the handlebars. They stared beautifully in his middle-aged lawyer’s face as, in “The Verdict”, he was handed an enormous cheque which he refused to take. They were so blue that they registered even in black and white. As he stepped out of the ranch door in “Hud”, casually buttoning his shirt, or as he woke himself up in “The Hustler” for another frame with Minnesota Fats after 25 hours at the pool table, you could have sworn they glowed with the colour of some deep, distant sky.

Paul Newman himself thought little of them. He hid them behind sunglasses, and sometimes asked his fans whether this was all they valued him for. His epitaph, he once said, should be “Here lies Paul Newman, who died a failure because his eyes turned brown.”

He also thought little of those screen performances. Until the 1990s he could not bear to watch himself. He so hated his first appearance, swaddled in a toga in “The Silver Chalice” in 1954, that he took out an advertisement in *Variety* begging people not to see it. He despaired later that people seemed to like him as “the cocky hero and the smart-ass and the rake”. In the end, the only self-reinvention that completely pleased him was the grinning man on the label of “Newman’s Own” balsamic dressing. His sauces and snacks, sold for charity from 1982 onwards (“shameless exploitation in pursuit of the common good”), turned him into the most generous individual, relative to his income, in the 20th-century history of the United States.

With looks like his, by turns as sultry as Marlon Brando’s or as wistful as James Dean’s, he could have been any number of romantic leads. Instead he played con men (“The Sting”), petty criminals (“Cool Hand Luke”), abusive husbands (“Cat on a Hot Tin Roof”) and a string of tough but vulnerable outsiders. Even these had moments of electric sexiness: Fast Eddie in “The Hustler” stroking a baize table, Hud nibbling on a flower. But they also gulped the bourbon down. The typical landscape of a Newman film was the raw sidestreets of a city or the empty plains, in which a man would try to get a grip on an aimless, violent life. He chose such parts, not always for the best, because the role of anti-hero was a challenge and an act of defiance.

Celebrity bugged him in every aspect: the studio contract system, from which he rapidly escaped, the Hollywood gossip mill, from which he fled into long-term marriage, motor-racing and Connecticut, the loveless pressure for Oscars and nominations. All this was "rubbish". He did not care whether his name was on the right or left of the poster, and bigger or smaller than Steve McQueen's. He was unbothered when age began to furrow the brow and fill out the jowls. Unlike Robert Redford, his partner for both "Butch Cassidy" and "The Sting", he made no attempt to preserve his prettiness. Hollywood could deal with him as he was.

A bolt of lightning

Indifferent to stardom, he was modest too about how he had earned it. He picked up method acting at the Actors Studio in New York, but never felt it particularly worked for him. Acting was "fiction" to which his own experience—though he too fought with drink, broke up a marriage and had to face the death of a child—was "irrelevant". His craft had grown on him at Kenyon College in the late 1940s, between football and beer-bouts that sometimes landed him in jail. He supposed he mostly wanted to escape a career in his father's sporting-goods store in Cleveland.

Luck had made the difference to him. Luck to be spotted by talent scouts at Yale, and taken in 1952 to New York; luck to get into a hit show on Broadway; luck to be snapped up by Warner Brothers the next year; luck to be picked for his breakthrough film in 1956, about the boxer Rocky Graziano, because Dean, the first choice, had been killed in a car crash. The film was called "Somebody Up There Likes Me". Mr Newman agreed; all his life, somebody did, from the blue eyes onwards.

His urge to give something back grew out of that. It began as a joke, putting home-made salad dressing in an old wine bottle, tying it with a ribbon and giving it to friends. He made more and more, went into partnership, pressed cases on the local grocer, and in two years had a multi-million-dollar business. All profits after tax, more than $250m so far, went to charitable causes round the world, of which his favourite were his 11 Hole in the Wall Camps for children with life-threatening illnesses. There, freed from hospitals, they could "raise a little hell" for a while.

He liked to do the same. Mr Newman was not a man for plans; he preferred creative chaos. He saw himself first as an inventor, whether of sauces or parts. His favourite directors were those, like Sidney Lumet on "The Verdict", who were open and responsive to his own fizzing ideas. Mr Redford, with whom he memorably jumped off a cliff and raced out of a mission into hundreds of Bolivian rifles, said he had "the attention span of a bolt of lightning". That sense of a lightning-strike returned whenever the camera fixed on him, its blue-eyed boy.

Overview

Oct 2nd 2008
From The Economist print edition

Stockmarkets fell sharply as the American government's $700 billion bail-out scheme stalled at the first hurdle in Congress. The S&P500 index slumped by 8.8% on September 29th, its biggest one-day drop since 1987. The Dow Jones Industrial Average index fell by 777.7 points, the largest one-day points fall ever. Stockmarkets regained some of the lost ground a day later on hopes that a modified plan would be approved.

There were worrying signs that strains in financial markets are hurting **America's economy**. The Institute for Supply Management's manufacturing index fell from 49.9 to 43.5 in September. A reading below 50 points to shrinking activity. House prices fell by 16.3% in the year to July on the measure of prices in 20 big cities compiled by S&P/Case Shiller.

The unemployment rate in the **euro area** rose to 7.5% in August. The jobless rate for July was revised from 7.3% to 7.4%. Consumer price inflation edged down from 3.8% in August to 3.6% in September, according to a preliminary estimate.

Business confidence in **Japan** has turned negative, according to the central bank's quarterly Tankan survey. The percentage balance of large manufacturers reporting “favourable” over “unfavourable” conditions fell to minus three in September from five in June. Japan's industrial production fell by 3.5% in August, leaving it 6.9% lower than a year earlier. The unemployment rate rose from 4% to 4.2%.

Output, prices and jobs

Oct 2nd 2008
From The Economist print edition

Output, prices and jobs

% change on year ago

	Gross domestic product				Industrial production	Consumer prices			Unemployment
	latest	qtr*	2008†	2009†	latest	latest	year ago	2008†	rate‡, %
United States	+2.1 Q2	+2.8	+1.6	+1.3	−1.5 Aug	+5.4 Aug	+2.0	+4.2	6.1 Aug
Japan	+0.7 Q2	−3.0	+1.0	+0.9	−6.9 Aug	+2.1 Aug	−0.2	+1.6	4.2 Aug
China	+10.1 Q2	na	+9.8	+8.5	+12.8 Aug	+4.9 Aug	+6.5	+6.7	9.5 2007
Britain	+1.5 Q2	nil	+1.2	+0.6	−1.9 Jul	+4.7 Aug§	+1.8	+3.7	5.5 Jul††
Canada	+0.7 Q2	+0.3	+1.1	+2.0	−5.9 Jun	+3.5 Aug	+1.7	+2.5	6.1 Aug
Euro area	+1.4 Q2	−0.8	+1.3	+0.9	−1.7 Jul	+3.6 Sep	+2.1	+3.6	7.5 Aug
Austria	+2.2 Q2	+1.5	+2.3	+1.6	−0.4 Jul	+3.7 Aug	+1.7	+3.0	3.3 Aug
Belgium	+1.9 Q2	+0.9	+1.5	+1.1	−3.2 Jun	+5.5 Sep	+1.5	+4.4	11.2 Aug‡‡
France	+1.1 Q2	−1.3	+1.2	+1.0	−2.0 Jul	+3.2 Aug	+1.2	+3.3	8.0 Aug
Germany	+1.7 Q2	−2.0	+1.8	+1.1	−0.6 Jul	+2.9 Sep	+2.7	+3.0	7.6 Sep
Greece	+3.5 Q2	+3.1	+2.4	+1.5	−1.3 Jul	+4.7 Aug	+2.5	+4.6	7.3 Jun
Italy	−0.1 Q2	−1.1	+0.2	+0.5	−3.2 Jul	+3.8 Sep	+1.7	+3.5	6.8 Q2
Netherlands	+3.0 Q2	+0.5	+2.3	+1.3	−2.6 Jul	+3.2 Aug	+1.1	+2.4	3.9 Aug††
Spain	+1.8 Q2	+0.4	+1.4	+0.6	−3.0 Jul	+4.9 Aug	+2.2	+4.5	11.3 Aug
Czech Republic	+4.6 Q2	+3.6	+4.5	+4.9	+6.7 Jul	+6.5 Aug	+2.4	+6.7	5.3 Aug
Denmark	+0.9 Q2	+1.6	+0.8	+0.8	+0.4 Jul	+4.3 Aug	+1.1	+3.5	1.6 Aug
Hungary	+2.0 Q2	+2.3	+2.0	+3.3	+0.6 Jul	+6.5 Aug	+8.3	+6.5	7.5 Aug††
Norway	+5.9 Q2	+2.4	+2.5	+2.2	+1.9 Jul	+4.5 Aug	+0.4	+3.3	2.4 Jul***
Poland	+5.8 Q2	na	+5.4	+4.3	−3.7 Aug	+4.8 Aug	+1.5	+4.2	9.3 Aug‡‡
Russia	+7.8 Q2	na	+7.5	+6.8	+4.7 Aug	+14.7 Jul	+8.7	+14.0	5.3 Aug‡‡
Sweden	+0.7 Q2	−0.1	+1.7	+1.6	+0.9 Jul	+4.3 Aug	+1.8	+3.9	5.2 Aug††
Switzerland	+2.4 Q2	+1.5	+2.0	+1.3	+6.1 Q2	+2.9 Aug	+0.4	+2.7	2.5 Aug
Turkey	+1.9 Q2	na	+4.5	+4.3	+3.4 Jul	+11.8 Aug	+7.4	+11.0	9.0 Q3‡‡
Australia	+2.7 Q2	+1.1	+2.7	+2.6	+2.4 Q1	+4.5 Q2	+2.1	+4.4	4.1 Aug
Hong Kong	+4.2 Q2	−5.5	+4.7	+4.4	−4.2 Q2	+4.6 Aug	+1.6	+5.3	3.2 Aug††
India	+7.9 Q2	na	+7.7	+7.1	+7.1 Jul	+8.3 Jul	+6.5	+7.1	7.2 2007
Indonesia	+6.5 Q2	na	+5.8	+5.5	+1.4 Jul	+11.8 Aug	+5.5	+10.3	8.5 Feb
Malaysia	+6.3 Q2	na	+6.0	+5.6	+1.8 Jul	+8.5 Aug	+1.9	+5.4	3.6 Q1
Pakistan	+5.8 2008**	na	+6.0	+4.4	−4.2 Jun	+25.3 Aug	+6.5	+18.6	5.6 2007
Singapore	+2.1 Q2	−6.0	+4.0	+3.8	−12.2 Aug	+6.4 Aug	+2.9	+6.5	2.3 Q2
South Korea	+4.8 Q2	+3.4	+4.4	+4.2	+1.9 Aug	+5.1 Sep	+2.3	+4.2	3.2 Aug
Taiwan	+4.3 Q2	na	+4.3	+3.4	+0.4 Aug	+4.8 Aug	+1.6	+3.8	3.9 Aug
Thailand	+5.3 Q2	+2.9	+4.8	+3.9	+10.9 Jul	+6.0 Sep	+2.1	+6.4	1.2 Jun
Argentina	+7.5 Q2	+8.7	+6.0	+3.5	+4.2 Aug	+9.0 Aug	+8.7	+9.3	7.8 Q3‡‡
Brazil	+6.1 Q2	+6.6	+4.6	+3.4	+8.5 Jul	+6.2 Aug	+4.2	+6.0	7.6 Aug‡‡
Chile	+4.3 Q2	+7.4	+3.6	+3.6	−3.1 Aug	+9.3 Aug	+4.7	+8.6	8.2 Aug††‡‡
Colombia	+3.7 Q2	+2.8	+4.5	+4.0	+0.7 Jul	+7.6 Sep	+5.0	+6.7	11.0 Jul‡‡
Mexico	+2.8 Q2	+0.6	+2.3	+2.5	−0.3 Jul	+5.6 Aug	+4.0	+4.8	4.2 Aug‡‡
Venezuela	+7.1 Q2	na	+5.2	+3.0	−2.5 Jun	+34.5 Aug	+16.0	+30.6	7.5 Q2‡‡
Egypt	+6.6 Q2	na	+7.1	+6.7	+7.5 2007**	+23.7 Aug	+8.1	+17.1	9.0 Q1‡‡
Israel	+4.9 Q2	+4.2	+4.0	+3.2	+9.7 Jul	+5.0 Aug	+1.0	+4.3	5.9 Q2
Saudi Arabia	+3.5 2007	na	+7.2	+5.1	na	+11.1 Jul	+3.8	+8.5	na
South Africa	+4.5 Q2	+4.9	+3.2	+3.5	+3.3 Jul	+13.7 Aug	+6.7	+10.3	23.1 Jun‡‡
MORE COUNTRIES Data for the countries below are not provided in printed editions of *The Economist*									
Estonia	−1.1 Q2	−3.2	−0.6	+2.0	−2.6 Aug	+11.0 Aug	+5.7	+10.5	4.0 Jul
Finland	+2.4 Q2	+3.1	+2.6	+1.1	−1.4 Jul	+4.7 Aug	+2.3	+4.0	6.4 Aug
Iceland	+5.0 Q2	+20.9	nil	+0.8	+0.4 2007	+14.0 Sep	+4.2	+12.0	1.2 Aug‡‡
Ireland	−0.8 Q2	−2.1	−0.5	−0.1	−4.5 Jul	+4.3 Aug	+4.8	+4.0	6.3 Sep
Latvia	+0.1 Q2	na	−0.4	+0.5	−6.9 Jul	+15.7 Aug	+10.1	+15.8	5.7 Jul
Lithuania	+5.2 Q2	+4.5	+5.5	+4.8	na	+11.9 Aug	+5.6	+11.0	4.7 Aug‡‡
Luxembourg	+2.5 Q1	+5.3	+2.8	+2.6	+7.5 Jul	+4.0 Aug	+1.9	+4.0	4.1 Jul‡‡
New Zealand	−0.3 Q2	−2.1	+0.7	+1.6	+2.4 Q1	+4.0 Q2	+2.0	+4.1	3.9 Q2
Peru	+8.3 Jul	na	+7.9	+6.6	+7.0 Jul	+6.2 Sep	+2.8	+5.3	9.2 Jul‡‡
Philippines	+4.6 Q2	+8.4	+4.7	+5.4	+5.1 Jun	+12.5 Aug	+2.4	+9.6	7.4 Q3‡‡
Portugal	+0.7 Q2	+1.4	+1.4	+1.3	−0.4 Jul	+3.0 Aug	+2.0	+2.7	7.3 Q2‡‡
Slovakia	+7.6 Q2	na	+7.5	+5.2	+1.8 Jul	+5.0 Aug	+2.3	+4.2	7.4 Aug††
Slovenia	+5.5 Q2	na	+4.5	+4.0	−4.6 Jul	+5.5 Sep	+3.5	+6.0	6.5 Jul‡‡

*% change on previous quarter, annual rate. †*The Economist* poll or Economist Intelligence Unit estimate/forecast. ‡National definitions.- §RPI inflation rate4.8% in Aug. **Year ending June. ††Latest three months. ‡‡Not seasonally adjusted. ***Centred 3-month average

Sources: National statistics offices and central banks; Thomson Datastream; Reuters; Centre for Monitoring Indian Economy; OECD; ECB

The Economist commodity-price index

Oct 2nd 2008
From The Economist print edition

The Economist commodity-price index

2000=100

	Sep 23rd	Sep 30th*	% change on one month	% change on one year
Dollar index				
All items	226.0	210.0	-10.5	-3.1
Food	232.2	214.7	-10.7	+9.2
Industrials				
All	218.0	203.9	-10.4	-16.0
Nfa†	182.1	170.0	-10.4	+2.7
Metals	237.6	222.5	-10.4	-22.0
Sterling index				
All items	184.7	178.6	-10.4	+10.9
Euro index				
All items	141.9	138.2	-7.5	-2.4
Gold				
$ per oz	901.15	877.60	+10.1	+20.4
West Texas Intermediate				
$ per barrel	108.28	101.26	-8.2	+26.2

*Provisional †Non-food agriculturals.

Perceptions of corruption

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From The Economist print edition

Small, rich countries tend to be the least corrupt, according to Transparency International. Each year it compiles a Corruption Perception Index based on surveys of business and expert opinion. The 2008 report ranks Denmark, New Zealand and Sweden as the least corrupt countries. Somalia has the most corrupt public officials. Italy is the lowest-ranked of the big rich countries. Russia’s score is scarcely higher than conflict-ridden states such as Iraq. Perceptions of corruption change only slowly, but the report notes improvements in some countries, including Georgia, Nigeria, South Korea and Turkey. It also detects a significant drop in standards in rich countries, such as Britain and Norway.

Trade, exchange rates, budget balances and interest rates

Oct 2nd 2008
From The Economist print edition

Trade, exchange rates, budget balances and interest rates

	Trade balance* latest 12 months, $bn	Current-account balance latest 12 months, $bn	Current-account balance % of GDP 2008†	Currency units, per $ Oct 1st	Currency units, per $ year ago	Budget balance % of GDP 2008†	Interest rates, % 3-month latest	Interest rates, % 10-year gov't bonds, latest
United States	−844.6 Jul	−699.0 Q2	−4.8	–	–	−2.5	2.09	3.77
Japan	+88.2 Jul	+206.4 Jul	+3.7	106	117	−2.8	0.75	1.50
China	+252.5 Aug	+371.8 2007	+8.3	6.85	7.51	0.6	4.30	3.83
Britain	−187.4 Jul	−82.9 Q2	−3.4	0.56	0.49	−3.8	6.30	4.42
Canada	+49.3 Jul	+13.6 Q2	+0.9	1.06	1.00	0.2	1.89	3.80
Euro area	−10.8 Jul	−38.5 Jul	−0.3	0.71	0.71	−0.9	5.29	3.98
Austria	+0.1 Jun	+14.5 Q2	+2.9	0.71	0.71	−0.8	5.29	4.42
Belgium	+5.5 Jun	−9.8 Jun	+0.7	0.71	0.71	−0.6	5.36	4.56
France	−71.9 Jul	−51.3 Jul	−1.7	0.71	0.71	−2.9	5.29	4.30
Germany	+284.9 Jul	+271.9 Jul	+6.7	0.71	0.71	1.1	5.29	3.98
Greece	−66.6 Jun	−50.5 Jul	−14.0	0.71	0.71	−3.3	5.29	4.87
Italy	−13.1 Jul	−71.4 Jul	−2.6	0.71	0.71	−2.6	5.29	4.81
Netherlands	+61.4 Jul	+62.5 Q2	+5.8	0.71	0.71	0.7	5.29	4.30
Spain	−154.1 Jul	−165.2 Jul	−9.8	0.71	0.71	−1.6	5.29	4.53
Czech Republic	+6.1 Jul	−4.8 Jul	−2.7	17.5	19.5	−1.8	3.98	4.30
Denmark	+5.1 Jul	+3.9 Jul	+1.1	5.33	5.27	3.8	5.95	4.31
Hungary	+0.5 Jul	−8.8 Q2	−5.9	174	178	−4.0	8.73	8.30
Norway	+80.5 Aug	+78.1 Q2	+17.3	5.91	5.43	17.7	7.91	4.31
Poland	−19.7 Jul	−22.0 Jul	−4.9	2.43	2.67	−1.9	6.67	5.80
Russia	+182.7 Jul	+109.8 Q2	+6.2	25.7	25.0	4.5	11.00	7.77
Sweden	+18.7 Aug	+38.6 Q2	+7.7	6.95	6.50	2.4	4.23	3.80
Switzerland	+16.4 Aug	+60.2 Q2	+14.5	1.12	1.18	0.9	2.98	2.49
Turkey	−76.0 Aug	−47.1 Jul	−6.4	1.28	1.20	−2.7	nil	7.25‡
Australia	−15.6 Aug	−61.1 Q2	−5.1	1.27	1.13	1.3	6.96	5.71
Hong Kong	−26.3 Aug	+27.5 Q2	+9.0	7.77	7.76	3.0	3.66	2.76
India	−100.3 Aug	−17.5 Q1	−3.2	46.6	39.6	−3.4	8.62	9.31
Indonesia	+21.0 Jul	+6.3 Q2	+2.8	9,430	9,124	−2.0	11.03	8.30‡
Malaysia	+39.7 Jul	+35.3 Q2	+14.4	3.44	3.41	−3.1	3.70	4.74‡
Pakistan	−21.7 Aug	−14.0 Q2	−8.6	78.3	60.7	−6.4	14.49	18.98‡
Singapore	+25.5 Aug	+32.8 Q2	+20.3	1.44	1.48	1.0	1.81	3.12
South Korea	−11.5 Sep	−7.1 Aug	−2.5	1,187	914	1.5	5.83	5.80
Taiwan	+9.3 Aug	+32.6 Q2	+4.6	32.0	32.6	−1.8	2.70	2.18
Thailand	+5.4 Aug	+7.8 Aug	+1.1	34.0	34.2	−2.9	3.85	4.35
Argentina	+13.2 Aug	+6.0 Q2	+3.1	3.13	3.15	0.7	13.69	na
Brazil	+28.8 Sep	−21.9 Aug	−1.6	1.93	1.82	−1.6	13.66	6.16‡
Chile	+17.8 Aug	+1.0 Q2	−0.3	555	505	6.5	8.28	3.85‡
Colombia	+1.8 Jul	−5.0 Q1	−2.6	2,184	2,013	−1.0	9.61	6.70‡
Mexico	−9.4 Aug	−5.3 Q2	−0.8	11.0	10.9	−0.1	8.12	8.34
Venezuela	+41.9 Q2	+37.8 Q2	+12.1	4.50	4.23§	1.6	17.00	6.55‡
Egypt	−22.2 Q1	−0.1 Q1	+0.2	5.46	5.58	−7.1	13.50	4.58‡
Israel	−13.1 Aug	+3.5 Q2	+0.2	3.48	4.01	−1.0	4.21	5.42
Saudi Arabia	+150.8 2007	+95.0 2007	+33.1	3.76	3.74	13.3	4.40	na
South Africa	−10.3 Aug	−22.5 Q2	−8.0	8.29	6.89	0.4	12.20	8.83
MORE COUNTRIES Data for the countries below are not provided in printed editions of *The Economist*								
Estonia	−4.3 Jul	−3.4 Jul	−10.8	11.2	11.1	−0.4	6.38	na
Finland	+12.2 Jul	+11.5 Jul	+3.8	0.71	0.71	4.5	5.29	4.38
Iceland	−1.0 Aug	−4.5 Q2	−14.6	110	61.3	2.0	15.97	na
Ireland	+38.2 Jul	−15.8 Q2	−3.5	0.71	0.71	−3.9	5.29	4.56
Latvia	−7.1 Jul	−5.7 Jul	−13.8	0.51	0.50	−1.5	6.70	na
Lithuania	−7.9 Jul	−5.9 Jul	−14.0	2.47	2.44	−0.7	6.06	na
Luxembourg	−6.9 Jul	+5.1 Q2	na	0.71	0.71	0.5	5.29	na
New Zealand	−3.2 Aug	−11.4 Q2	−7.1	1.48	1.32	1.2	7.20	5.77
Peru	+6.3 Jul	−1.5 Q2	−1.1	2.98	3.02	2.3	6.55	na
Philippines	−8.7 Jul	+4.3 Jun	+2.8	47.1	45.1	−0.8	4.13	na
Portugal	−31.9 Jun	−27.9 Jun	−9.0	0.71	0.71	−2.5	5.29	4.65
Slovakia	−1.2 Jul	−5.6 Jun	−4.7	21.7	24.2	−2.1	2.35	4.83
Slovenia	−4.3 Jul	−3.1 Jul	−5.8	0.71	0.71	0.1	5.29	na

*Merchandise trade only. †*The Economist* poll or Economist Intelligence Unit forecast. ‡Dollar-denominated bonds. §Unofficial exchange rate.
Sources: National statistics offices and central banks; Thomson Datastream; Reuters; JPMorgan; Bank Leumi le-Israel; Centre for Monitoring Indian Economy; Danske Bank; Hong Kong Monetary Authority; Standard Bank Group; UBS; Westpac.

Markets

Oct 2nd 2008
From The Economist print edition

Markets

		% change on	Dec 31st 2007	
	Index Oct 1st	one week	in local currency	in $ terms
United States (DJIA)	10,831.1	+0.1	−18.3	−18.3
United States (S&P 500)	1,161.1	−2.1	−20.9	−20.9
United States (NAScomp)	2,069.4	−4.0	−22.0	−22.0
Japan (Nikkei 225)	11,368.3	−6.2	−25.7	−21.4
Japan (Topix)	1,101.1	−5.7	−25.4	−21.0
China (SSEA)	2,408.9	+3.5	−56.4	−53.5
China (SSEB, $ terms)	132.8	+4.7	−66.0	−63.7
Britain (FTSE 100)	4,959.6	−2.7	−23.2	−31.7
Canada (S&P TSX)	11,714.5	−6.4	−15.3	−21.3
Euro area (FTSE Euro 100)	945.6	−2.6	−31.2	−34.1
Euro area (DJ STOXX 50)	3,067.4	−1.7	−30.3	−33.2
Austria (ATX)	2,767.4	−11.4	−38.7	−41.3
Belgium (Bel 20)	2,716.5	−5.2	−34.2	−37.0
France (CAC 40)	4,054.5	−1.5	−27.8	−30.8
Germany (DAX)*	5,806.3	−4.1	−28.0	−31.1
Greece (Athex Comp)	2,837.2	−7.4	−45.2	−47.5
Italy (S&P/MIB)	25,681.0	−4.6	−33.4	−36.2
Netherlands (AEX)	334.2	−7.3	−35.2	−37.9
Spain (Madrid SE)	1,196.7	+0.6	−27.1	−30.2
Czech Republic (PX)	1,235.3	−3.7	−31.9	−29.4
Denmark (OMXCB)	326.3	−9.1	−27.3	−30.4
Hungary (BUX)	19,174.5	+3.2	−26.9	−27.2
Norway (OSEAX)	365.4	−10.9	−35.9	−41.1
Poland (WIG)	37,783.1	+0.8	−32.1	−31.2
Russia (RTS, $ terms)	1,189.1	−9.6	−45.5	−48.1
Sweden (Aff.Gen)	237.3	−5.3	−30.3	−35.2
Switzerland (SMI)	6,727.6	−0.8	−20.7	−19.9
Turkey (ISE)	36,051.3	+2.5	−35.1	−40.4
Australia (All Ord.)	4,814.5	−3.9	−25.0	−32.4
Hong Kong (Hang Seng)	18,016.2	−5.0	−35.2	−35.0
India (BSE)	13,055.7	−4.7	−35.6	−45.6
Indonesia (JSX)	1,832.5	−2.7	−33.3	−33.5
Malaysia (KLSE)	1,018.7	−0.9	−29.5	−32.3
Pakistan (KSE)	9,179.7	−0.1	−34.8	−48.6
Singapore (STI)	2,358.9	−4.8	−31.9	−31.8
South Korea (KOSPI)	1,439.7	−3.8	−24.1	−40.2
Taiwan (TWI)	5,764.0	−6.0	−32.2	−31.4
Thailand (SET)	594.5	−4.2	−30.7	−31.4
Argentina (MERV)	1,605.7	−3.0	−25.4	−24.9
Brazil (BVSP)	49,798.0	−0.1	−22.1	−28.3
Chile (IGPA)	13,053.7	+0.3	−7.3	−16.9
Colombia (IGBC)	9,296.9	nil	−13.1	−19.7
Mexico (IPC)	25,117.3	+0.7	−15.0	−15.6
Venezuela (IBC)	37,934.8	−1.7	+0.1	−52.2
Egypt (Case 30)	7,059.2	+1.6	−32.6	−31.9
Israel (TA-100)	803.8	+1.4	−30.4	−23.0
Saudi Arabia (Tadawul)	7,458.5	+4.6	−32.4	−32.6
South Africa (JSE AS)	23,332.7	−6.4	−19.4	−33.6
Europe (FTSEurofirst 300)	1,072.6	−2.6	−28.8	−31.8
World, dev'd (MSCI)	1,184.3	−4.8	−25.5	−25.5
Emerging markets (MSCI)	786.2	−5.4	−36.9	−36.9
World, all (MSCI)	295.2	−4.9	−26.8	−26.8
World bonds (Citigroup)	746.2	−1.5	+2.2	+2.2
EMBI+ (JPMorgan)	411.9	−2.2	−5.0	−5.0
Hedge funds (HFRX)	1,175.4	−2.0	−11.6	−11.6
Volatility, US (VIX)	39.8	35.2	22.5	(levels)
CDSs, Eur (iTRAXX)†	119.3	+2.4	+135.7	+125.7
CDSs, N Am (CDX)†	175.3	+1.6	+125.1	+125.1
Carbon trading (EU ETS) €	22.8	−7.3	+2.7	−1.7

*Total return index. †Credit-default swap spreads, basis points.
Sources: National statistics offices, central banks and stock exchanges; Thomson Datastream; Reuters; WM/Reuters; JPMorgan Chase; Bank Leumi le-Israel; CBOE; CMIE; Danske Bank; EEX; HKMA; Markit; Standard Bank Group; UBS; Westpac.

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MARKETS & DATA
WEEKLY INDICATORS

Global infrastructure firms

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Britain’s Vodafone is the world’s largest multinational infrastructure firm, according to *World Investment Report 2008* from the United Nations. Three other telecoms operators, one each from Spain, France and Germany, are in the top six firms ranked by the value of foreign assets. The remaining top-six companies are EDF and E.ON, the French and German electricity giants. Hutchison Whampoa, a seaports, electricity and telecoms group, is the only Asian firm in the top ten. Liberty Global is the highest-ranked American firm, though its foreign operation is small compared with those of European telecoms firms. América Móvil, another telecoms firm, has expanded beyond its home market in Mexico.